(27,254)

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1919.

No. 499.

THE PENN MUTUAL LIFE INSURANCE COMPANY, PETITIONER,

vs.

EPHRAIM LEDERER, COLLECTOR OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

INDEX.

	Original.	Print.
Caption	*a*	1
Transcript of record from the district court of the United States for the eastern district of Pennsylvania	1	1
Docket entries	1	1
Writ of error	3	2
Plaintiff's statement of claim	4	3
Affidavit of defense	8	5
Stipulation waiving trial by jury	9	6
Stipulation as to Exhibits "A," "B," and "C"	9	6
Plaintiff's Exhibit "C"—Summary of dividends	10	8
"A"—Notice of assessment of special excise and income tax	11	9
"B"—Protest	11	9
"C"—Receipt	13	10
"D"—Claim for refund	14	10
"E"—Letter, June 23, 1915	15	12
Bill of exceptions	16	12

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JANUARY 31, 1920.

	Original	Print.
Testimony of Frederick H. Garrigues	27	20
Plaintiff's Exhibit "No. 1-*a*"—Form of policy	111	75
"No. 1-*b*"—Form of policy	112	75
"No. 1-*c*"—Form of policy	112	75
"No. 2-*a*"—Form of policy	113	76
"No. 3-*a*"—Form of policy	113	76
"No. 3-*b*"—Form of policy	114	76
"No. 4-*a*"—Summary of life rate endowment	114	77
"No. 4-*b*"—Summary of policy No. 330,393	115	78
"No. 5-*a*"—Form of policy	116	78
"No. 5-*b*"—Form of policy	116	79
"No. 5-*c*"—Summary of policy No. 265,957	117	79
"No. 6-*a*"—Form of policy	117	80
"No. 6-*b*"—Form of policy	118	80
"No. 6-*c*"—Summary of policy No. 232,579	118	81
"No. 6*d*"—Accumulated surplus, policy No. 232,579	119	81
"No. 7-*a*"—Form of policy	121	83
"No. 7-*b*"—Form of policy	121	83
"No. 8-*a*"—Form of policy	122	83
"No. 8-*b*"—Form of policy	122	84
"No. 9"—Summary of 4 per cent investment bond	123	85
"No. 10"—Summary of division of interest, forfeitures, and premiums	124	86
Opinion of the court (Dickinson, J)	125	87
Plaintiff's requests for findings of fact	139	96
Plaintiff's requests for findings of law	145	99
Defendant's requests for findings of fact	145	100
Defendant's requests for conclusions of law	146	100
Answer to requests for findings of fact and conclusions of law (Dickinson, J)	147	101
Exceptions allowed defendant	149	102
Judge's certificate to bill of exceptions	149	102
Judgment	150	103
Petition for writ of error and order of allowance	150	103
Assignment of errors	151	103
Præcipe for transcript of record	161	110
Clerk's certificate	162	110
Argument in court of appeals	163	111
Opinion, Haight, circuit judge	164	111
Order reversing judgment	184	122
Clerk's certificate	185	123
Writ of certiorari and return	186	123

a *Certified Original Transcript of Record.*

In the United States Circuit Court of Appeals for the Third Circuit, October Term, 1918.

No. 2399.

EPHRAIM LEDERER, Collector of Internal Revenue, Plaintiff in Error.

vs.

THE PENN MUTUAL LIFE INSURANCE COMPANY, Defendant in Error.

In error to the District Court of the United States for the Eastern District of Pennsylvania.

1 *Docket Entries.*

In the District Court of the United States for the Eastern District of Pennsylvania, June Sessions, 1915.

No. 3724.

THE PENN MUTUAL LIFE INSURANCE COMPANY, Assumpsit,

vs.

EPHRAIM LEDERER, Collector of Internal Revenue.

G. W. Pepper.
Francis Fisher Kane.

July 3, 1915.	Præcipe for summons filed.
	Summons exit returnable the first Monday of July next.
	Statement of claim filed.
	Rule to plead filed.
" 6, "	Summons returned "Served with copy of statement" and filed.
" 8, "	Order for the appearance of Francis Fisher Kane, Esquire, for defendant filed.
Feby. 24, 1917.	Affidavit of defense filed.
Nov. 3, 1917.	Order to place case on trial list filed.

2

"	8, "	Stipulation as to certain evidence filed.
"	8, "	Plaintiff's Exhibit "C" filed.
Nov.	8, 1917.	Schedule of Dividends left with plaintiff company at interest, 1913, filed.
"	8, "	Schedule of Dividends etc., 1913, filed.
Dec.	28, 1917.	Stipulation for trial before the Court without a jury filed.
"	28, "	Trial before the Court without a jury.
Feby.	4, 1918.	Testimony filed.
"	4, "	Opinion Dickinson J. granting judgment for plaintiff filed.
Mar.	20, 1918.	Plaintiff's requests for findings of law, filed.
"	20, "	Plaintiff's requests for finding of facts, filed.
"	20, "	Defendant's request for finding of fact, filed.
"	20, "	Defendant's request for conclusions of law, filed.
"	20, "	Opinion Dickinson J. in answer to requests for findings of fact and conclusions of law, filed.
Apr.	26, 1918.	Præcipe for judgment filed.
"	26. "	By order of præcipe filed, judgment is entered in favor of plaintiff and against defendant in sum of Eight Thousand Three Hundred Ninety-eight and 21-100 Dollars ($8398.21).
May	16, 1918.	Exceptions of defendant filed.
"	16, "	Bill of Exceptions filed.
"	16, "	Assignments of Error Filed.
"	16, "	Petition for Writ of Error filed.
"	16, "	Order of Court allowing Writ of Error, filed.

3

May	16, 1918.	Writ of Error allowed and copy thereof lodged in Clerk's office for adverse party.
"	16, "	Citation allowed and exit.
"	16, "	Præcipe for Record sur Writ of Error, filed.
"	18, "	Citation returned "service accepted" and filed.

UNITED STATES OF AMERICA, *ss:*

The President of the United States to the Honorable the Judges of the District Court of the United States for the Eastern District of Pennsylvania, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you, or some of you, between The Penn Mutual Life Insurance Company, Plaintiff, and Ephraim Lederer, Collector of Internal Revenue, Defendant, a manifest error hath happened, to the great damage of the said Ephraim Lederer, Collector of Internal Revenue, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the

parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the United States Circuit Court of Appeals for the Third Circuit, together with this writ, so that you have the same at the City of Philadelphia within thirty days, in the said United States Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done
4 therein to correct that error, what of right, and according to the laws and customs of the United States should be done.

Witness the Honorable Edward D. White, Chief Justice of the Supreme Court of the United States, at Philadelphia, the 16th day of May in the year of our Lord one thousand nine hundred and eighteen.

GEORGE BRODBECK,
[SEAL.] *Clerk of the District Court of the United States.*

Before Dickinson, J.

Allowed:
BY THE COURT.

Attest:
GEORGE BRODBECK,
Clerk.

Plaintiff's Statement of Claim.

(Filed July 3, 1915.)

1. The Penn Mutual Life Insurance Company, a corporation duly formed and existing under the laws of the Commonwealth of Pennsylvania, brings this suit to recover from the defendant, Ephraim Lederer, the sum of $6,865.03 with interest thereon from June 29, 1914, upon the cause of action whereof the following is a statement:

2. The defendant, Ephraim Lederer, was at all times hereinafter mentioned, and still is the Collector of Internal Revenue for the Eastern District of Pennsylvania, being duly commissioned as such pursuant to the laws of the United States.

3. On or about or prior to the thirtieth day of April 1914,
5 the United States Commissioner of Internal Revenue, presuming to act by virtue of the legal authority conferred by statutes of the United States Congress, assessed against the plaintiff, as an insurance company engaged in business in Pennsylvania, an additional Income Tax amounting to $18,247.82 upon net income for the year 1913.

4. The lists upon which said tax assessment appears were thereafter duly transmited to the defendant, as Collector aforesaid. The defendant thereupon made formal demand upon the plaintiff for

the payment of the said tax and served upon the plaintiff notice of the assessment of the said tax. A copy of the said notice is hereto annexed marked "Exhibit A."

5. The plaintiff admitted liability for the said tax for the year 1913 to the extent of $11,382.79. On June 29, 1914, the plaintiff paid to the defendant the said sum of $11,382.79 admitted to be due. The said assessment was excessive and illegal to the extent of $6,865.03. On the 29th day of June 1914, the plaintiff paid to the defendant, in addition to the amount which it admitted to be due, the amount of the said excessive and illegal assessment, to wit, $6,865.03, making the amount paid for the year 1913, $18,247.82. Prior to the said payment plaintiff was informed by defendant that if plaintiff refused to pay the tax so assessed the defendant would collect the said tax by distraint and sale of the plaintiff's property. At the time of said payment plaintiff filed with the defendant a written protest, a copy of which, together with the check delivered to defendant in payment of said tax, is hereto annexed marked "Exhibit B." The defendant gave to plaintiff a written receipt for the sum so paid, to wit, $18,247.82. A copy of the said receipt is hereto annexed marked "Exhibit C."

6. On or about the 13th day of July 1914, the plaintiff filed with the defendant a claim for refund of the tax so paid insofar
6 as it was excessive and illegal, to wit, to the extent of $6,-865.03. A copy of the said claim for refund is hereto annexed marked "Exhibit D." The said claim for refund was accepted by defendant.

7. After consideration of the said claim for refund of the said excessive tax assessment, the Commissioner of Internal Revenue rejected the same. Under date of June 23, 1915, the defendant sent the plaintiff a letter giving the reason for such rejection. A copy of the said letter is hereto annexed marked "Exhibit E." It is not true as in the said letter set forth that the plaintiff had on June 23, 1915, instituted suit to recover the amount of tax involved in he plaintiff's claim for refund of the said sum of $6,865.03 paid under protest for the year 1913.

8. The said tax to the extent of $6,865.03 was excessive and unjustly and illegally assessed against the plaintiff by the Commissioner of Internal Revenue and was illegally and wrongfully collected from the plaintiff by the defendant as Collector as aforesaid, for the following reason, to wit:

The amount upon which the said assessment for the year 1913 was made up included the item of tax assessed upon portions of actual premiums received from individual policyholders and paid back to such individual policyholders in cash between March 1, and December 31, 1913, the sum of $386,503.38. The said item was improperly and illegally, and without warrant in law, included by the said Commissioner of Internal Revenue in the amount upon which said assessment for the year 1913 was made. One per cent. of the said sum so improperly and illegally included amounts to $6,-865.03.

9. The plaintiff is advised, believes, and therefore avers that there existed no warrant in law for the assessment by the said Commissioner of the said additional Income Tax to the extent to
7 which it is held to be excessive as aforesaid, and to the extent to which a claim for refund was filed as aforesaid; and especially that there existed no warrant in law for demanding and collecting from the plaintiff the said excessive tax so assessed, there being no statute or law of the United States Congress imposing such tax upon the plaintiff.

Wherefore the plaintiff brings this suit to recover from the defendant the amount of the said excessive tax so assessed and collected as aforesaid, to wit, $6,865.03, with interest thereon from June 29, 1914.

G. W. PEPPER,
Per B. F. PEPPER,
Attorney for Plaintiff.

COMMONWEALTH OF PENNSYLVANIA,
County of Philadelphia, ss:

F. H. Garrigues being duly affirmed according to law, deposes and says that he is the Mathematician of The Penn Mutual Life Insurance Company, the above named plaintiff, and that the facts set forth in the foregoing statement of claim are true.

F. H. GARRIGUES.

Affirmed and subscribed to before me this 30th day of June, 1915.

FRANK J. REEVES,
Notary Public.

[SEAL.]

Commission expires February 21, 1919.

8 *Affidavit of Defense.*

(February 26, 1917.)

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, ss:

1. Ephraim Lederer, defendant above named, after having been duly affirmed, affirms and says that he has a just and full defense to the whole of plaintiff's claim, the nature and character of the said defense being as follows, each paragraph as numbered in the Statement being answered under its separate number.

2. Admitted.

3. Admitted.

4. Admitted.

5. The defendant admits the averments in paragraph 5 except that the assessment was excessive and illegal to the extent of $6,865.03,

which is denied for the reasons more particularly set forth in paragraphs 8 and 9 below.

6. Admitted.

7. Admitted.

8. The defendant denies that the said tax was unjustly and illegally assessed and collected, but submits to the court the legal questions raised by the plaintiff's contention.

9. The defendant is advised, believes and therefore avers that the said tax was legally collected.

The defendant for the reasons set forth above denies any liability whatever to the plaintiff.

EHPRAIM LEDERER,
Collector of Internal Revenue.

Affirmed and subscribed before me this 21st day of Feb. 1917.

[SEAL.] GEO. A. SILLY,
Deputy Clerk District Court United States, Eastern District of Pennsylvania.

9 *Stipulation.*

(Filed Dec. 28, 1917.)

And Now, December 28, 1917, it is stipulated and agreed by and between the attorneys of record for the respective parties that a trial by jury is waived, and that the issues of fact in the above case shall be tried and determined by the court, without the intervention of a jury, in accordance with sections 649 and 700 of the Revised Statutes of the United States.

GEO. W. PEPPER,
Attorney for Plaintiff.
FRANCIS FISHER KANE,
United States Attorney.

Stipulation.

(Filed Nov. 8, 1917.)

It is stipulated by and between the Plaintiff and Defendant in the above case that the Schedules filed herewith, marked "A" and "B," together with the Summary of Schedule "A," likewise annexed and marked "C," shall be admissible in evidence with the same force and effect as if the Plaintiff's books had been produced and the figures contained in the schedules and summary had been proved in the usual way; subject to the right of the defendant to object to the admissibility of the figures, or any of them, as being irrelevant, but not on the ground that the figures are not sufficiently proved, and

subject also to the right of either party to put the books or particular entries in them in evidence, if deemed desirable.

G. W. PEPPER,
Attorney for Plaintiff.
FRANCIS FISHER KANE,
United States Attorney.

PLAINTIFF'S EXHIBIT C

(Filed Nov. 8, 1917)

1913 SUMMARY OF DIVIDENDS, INTEREST, FORFEITURES AND PREMIUMS

KIND	INDIVIDUAL DIVS.	INTEREST	SHARE FORF.	TOTAL	LAST PREMIUM	RECEIVED PRIOR TO 1913	RECEIVED 1913
A's Policies							
Jan. & Feb.	$ 42,998.07	$ 18,772.75	$ 13,674.17	$ 75,444.99	$ 25,780.31	$ 23,998.52	$ 1,781.79
Mch-Dec.	195,870.77	76,068.59	58,112.08	330,051.44	117,615.69	100,231.79	17,383.90
Jan.-Dec. inc.	$238,868.84	$ 94,841.34	$ 71,786.25	$405,496.43	$143,396.00	$124,230.31	$ 19,165.69
Guar. Divs.							
Jan. & Feb.							
Mch-Dec.	$ 20,945.63	$ 10,912.14	$ 7,880.19	$ 39,737.96	$ 9,256.84	$ 6,872.77	$ 2,384.07
Jan.-Dec.	$ 20,945.63	$ 10,912.14	$ 7,880.19	$ 39,737.96	$ 9,256.84	$ 6,872.77	$ 2,384.07
4% I. Bond							
Jan. & Feb.	$ 4,586.22	$ 2,031.96	$ 1,337.76	$ 7,955.94	$ 3,112.35	$ 3,112.35	
Mch-Dec.	25,998.28	10,969.82	6,568.13	43,536.23	14,059.82	12,750.64	$ 1,309.18
Jan.-Dec.	$ 30,584.50	$ 13,001.78	$ 7,905.89	$ 51,492.17	$ 17,172.17	$ 15,862.99	$ 1,309.18
6% Bond							
Jan. & Feb.	$ 2,906.07	$ 2,356.40	$ 2,012.57	$ 7,275.04	$ 1,299.91	$ 1,299.91	
Mch-Dec.	12,340.87	10,353.98	9,816.27	32,511.12	4,218.23	2,777.16	$ 1,441.07
Jan.-Dec.	$ 15,246.94	$ 12,710.38	$ 11,828.84	$ 39,786.16	$ 5,518.14	$ 4,077.07	$ 1,441.07
L. R. End't							
Jan. & Feb.	$ 7,752.94	$ 4,203.90		$ 11,956.84	$ 15,898.06	$ 3,554.97	$ 12,343.09
Mch-Dec.	38,374.18	19,732.66		58,106.84	88,385.84	13,658.29	74,727.55
Jan.-Dec.	$ 46,127.12	$ 23,936.56		$ 70,063.68	$104,283.90	$ 17,213.26	$ 87,070.64
Acce'l End't							
Jan. & Feb.	$ 738.01	$ 61.71		$ 799.72	$ 1,899.47	$ 682.45	$ 1,217.02
Mch-Dec.	8,289.28	755.48		9,044.76	20,019.97	4,753.40	15,266.57
Jan.-Dec.	$ 9,027.29	$ 817.19		$ 9,844.48	$ 21,919.44	$ 5,435.85	$ 16,483.59
6's							
Jan. & Feb.	$ 11,691.89	$ 3,105.06		$ 14,796.95	$ 9,507.82	$ 4,384.84	$ 5,122.98
Mch-Dec.	51,944.95	14,257.01		66,201.96	42,841.33	23,763.20	19,078.13
Jan.-Dec.	$ 63,636.84	$ 17,362.07		$ 80,998.91	$ 52,349.15	$ 28,148.04	$ 24,201.11
Final Divs.							
Jan. & Feb.	$ 10,441.14			$ 10,441.14			
Mch-Dec.	74,151.44			74,151.44			
Jan.-Dec.	$ 84,592.58			$ 84,592.58			
Full Pd Divs.							
Jan. & Feb.	$ 1,935.21			$ 1,935.21			
Mch-Dec.	14,846.69			14,846.69			
Jan.-Dec.	$ 16,781.90			$ 16,781.90			
Trust Certif.							
Jan. & Feb.		$ 3,272.95		$ 3,272.95			
Mch-Dec.		15,540.59		15,540.59			
Jan.-Dec.		$ 18,813.54		$ 18,813.54			
Totals							
Jan. & Feb.	$ 83,049.55	$ 33,804.73	$ 17,024.50	$133,878.78	$ 57,497.92	$ 37,033.04	$ 20,464.88
Mch-Dec.	442,762.09	158,590.27	82,376.67	683,729.03	296,397.72	164,807.25	131,590.47
Jan.-Dec. inc.	$525,811.64	$192,395.00	$ 99,401.17	$817,607.81	$353,895.64	$201,840.29	$152,055.35

11 EXHIBIT A.

Form 647.

United States Internal Revenue.

Notice of Assessment of Special Excise and Income Tax.

List for month of — 1914.

United States Internal Revenue Office of the Collector.

First District of Pa., at Philadelphia, 191–.

To Penn Mutual Life Ins. Co., 921 Chestnut St.

You are hereby notified that an income tax, under the provisions of section 2 of the Act of October 3, 1913, amounting to $18,247.82, has been assessed against you by the Commissioner of Internal Revenue and transmitted by him to me for collection. This tax is due and payable on or before *the* June 30, 1914, to the person designated below in the manner set forth on the reverse side of this notice.

Payment may be made to Collector of Internal Revenue,
At Philadelphia.
(Post Office Address)
C2—6216. Or to Ephraim Lederer, Collector.
Bring this notice with you.

EXHIBIT B.

The Penn Mutual Life Insurance Co., Philadelphia.

June 29, 1914.

Hon. Ephraim Lederer,
Collector of Internal Revenue,
1st District of Pennsylvania,
Philadelphia, Pa.

SIR:

12 Pursuant to the notice and demand received from you, based upon the alleged assessment of a special excise and income tax against the undersigned for the year ending the 31st of December, 1913, by the Commissioner of Internal Revenue, under the pretended authority of Section 38 of the Act of Congress, approved the 5th of August, 1909, entitled "An Act to Provide Revenue, Equalize Duties, Encourage the Industries of the United States and for other Purposes," and of Section 2 of the Act of Congress, approved the 3d day of October, 1913, entitled "An Act to Reduce Tariff Duties and to Provide Revenue for the Government, and for other Purposes," payment is herewith made by Check No. 35184 duly drawn on and certified by The Franklin National Bank for Eighteen Thousand, Two Hundred Forty-seven and 82-100

Dollars ($18,247.82), said sum being the amount of the tax or taxes stated in said notice to be so assessed. Protest is hereby made against said assessment and against the execution of said tax or taxes, and each and every part thereof, and particularly so much thereof as purports to be based upon the authority of Section 2 of the Act last mentioned, upon the ground that the same are invalid, wrongful and excessive and contrary to the rights of the undersigned under the Constitution and laws of the United States, and such payment is made solely under compulsion of said notice and demand, to avoid the seizure of the lands and goods of the undersigned and the other pains and the penalties thereby threatened.

THE PENN MUTUAL LIFE INSURANCE CO.
By L. K. PASSMORE,
Vice-President.

13

The Penn Mutual Life Insurance Co.

No. 35184.

Philadelphia, 6-29-1914. $18,247.82.

Pay to the order of Collector of Internal Revenue, First District of Pennsylvania, Eighteen Thousand Two Hundred Forty-Seven and 82-100 Dollars.

Not over twenty thousand $20,000$.

Payable at the Franklin National Bank, Philadelphia.

M. HAMER,
Third Vice-President.
JOHN HUMPHREY,
Sec'y & Treas.

EXHIBIT C.

No. B 848,041.

United States Internal Revenue.

Office of Collector.

Form No. 1.

(Revised May 5, 1913.)

First District of Penna.,
June 27, 1914.

Received of Penn Mutual Life Insurance Co., Eighteen Thousand Two Hundred Forty-seven 82-100 Dollars, on account of Corporation Income Tax—1913 .....$ 18247.82

(Enter here on what account paid and period of liability, e. g.

.....$———

"Special excise tax, 1913," "50 per cent. penalty, R. L. D., 6 months June 30, 1913," "Offer in compromise," etc.)

Five per cent. penalty .....$———

Interest at 1 per cent. per month for — months .....$———

Total amount paid .....$ 18247.82

$18247.82.

EPHRAIM LEDERER,
H. *Collector.*

14 EXHIBIT D.

STATE OF PENNSYLVANIA,
County of Philadelphia, ss:

Lincoln K. Passmore, of the City of Philadelphia in the State and County aforesaid, being duly affirmed according to law, deposes and says that he is the Vice-President of the Penn Mutual Life Insurance Company, a corporation of the State of Pennsylvania, and that the said corporation is, and since 1847 has been, engaged in the business of life insurance, and that the said corporation was assessed on Income Tax of $18,247.82 with respect to the year 1913 under the Act of Congress of October 3, 1913, which amount the said corporation on the twenty-ninth day of June, 1914, paid Ephraim Lederer, Esq., Collector of Internal Revenue for the First District of Pennsylvania, and of which $6,865.03, as this deponent verily believes, should be refunded for the following reasons, viz:

Because, to the extent of the sum last mentioned, the assessment of said Income Tax was illegal and its collection was illegal. The said sum is made up of the following item:

Tax assessed upon portions of actual premiums paid back to individual policyholders in cash between March 1 and December 31, 1913 .....$686,563.38

1 per cent. of said total .....$ 6,865.03

And this deponent now claims that by reason of the payment of the said sum of $6,865.03, the said corporation is justly entitled to have the sum of $6,865.03 refunded, and it asks and demands the same.

And this deponent further makes affirmation that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented for the refunding of the above amount or any part thereof.

LINCOLN S. PASSMORE,
Vice-President, The Penn Mutual Life Insurance.

15 Affirmed and subscribed before me this 13th day of July, 1914.

FRANK J. REEVES,
Notary Public.

Commission expires February 21, 1919.

EXHIBIT E.

Treasury Department.

Internal Revenue Service.

Office of the Collector.

First District of Penna.

U. S. Post Office Building, Philadelphia, Pa.

June 23, 1915.

Penn Mutual Life Insurance Co.,
Philadelphia, Pa.
Legal Department.

SIRS:

I have received the following letter from the Honorable Commissioner of Internal Revenue:

"Replying to yours of the 17th instant, you are advised that the claims of the Penn Mutual Life Insurance Company of Philadelphia, Pa., for the refunding of $49,458.90, special excise taxes for the years 1911 and 1912, and $6,865.03 special excise tax paid on account of the year 1913, are hereby rejected, for the reason that this company has instituted suit to recover the amount of taxes involved.

Receipts on Form 1 did not accompany these claims.

You will please notify claimant of this action."

Respectfully,

E. LEDERER,
Collector.

16 District Court of the United States, Eastern District of Pennsylvania.

No. 3724.

PENN MUTUAL LIFE INSURANCE CO.

vs.

EPHRAIM LEDERER, Collector of Internal Revenue.

Bill of Exceptions.

Be It Remembered that in the June, 1918, Term of this Court, came the said plaintiff into the said Court, and impleaded the said defendant in a certain plea of assumpsit, &c., in which the said plaintiff declared (prout statement) and the said defendant pleaded (prout plea). And thereupon issue was joined between them.

And afterwards, to wit, at a session of said Court, held at the County aforesaid, before the Honorable O. B. Dickinson, Judge of

the said Court, on the 28th day of December, 1917, the said issue between the said parties came to be tried without a jury, at which day came as well the said plaintiff as the said defendant, by their respective attorneys, and, the witnesses being sworn, the following testimony was produced.

Philadelphia, Pa., Friday, December 28, 1917, 10 a.m.

Before Hon. O. B. Dickinson, J.

Present:

George Wharton Pepper, Esq., representing the Plaintiff.
E. St. Clair Thompson, Esq., and
Francis Fisher Kane, Esq., United States District Attorney, representing the defendant.

17 Mr. Kane: I want to move for Mr. E. S. Thompson's admission to help me in this case. He is a member of the bar from Washington, District of Columbia. He comes from Washington to help me. He is from the Internal Revenue Department. He is also a member of the bar of the Supreme Court of the United States.

(Mr. Thompson was admitted for the purposes of the trial of this case.)

Plaintiff's Evidence.

Mr. Pepper: May it please the Court, this is an action at law brought by the Penn Mutual Life Insurance Company of this City against the Collector of Internal Revenue, and by a stipulation which will presently be formally filed, a jury is dispensed with, and it is agreed between counsel for the respective parties that the case be tried by the Court.

The action is an action to recover a certain sum of money alleged to have been illegally exacted by the Government under the guise of a tax levy for the ten months of 1913, beginning with March 1st of that year, the taxing act, being the Income Tax Act, and that special portion of it which has relation to corporations, which was actually signed and became operative on the 3rd of October, 1913, but the taxing period contemplated by the Act covered the ten months to which I have referred.

The Court: That is, it was retroactive, then?

Mr. Pepper: Retroactive in that sense, that it laid a tax on income accruing during those ten months but made it payable as of the end of the period.

I believe it is a matter of history that the reason why the tax period began in the middle of that year, or at least otherwise
18 than at the beginning of the year, was that the constitutional amendment authorizing the imposition of the income tax had not become operative until March 1.

I think that perhaps I can simplify my statement of the case if I read into the record at this stage those averments of the statement

of claim which are specifically admitted by the affidavit of defence. If Mr. Kane will check me up, I think I am right in saying that the second, third, fourth, sixth and seventh paragraphs are specifically admitted, and that the fifth paragraph is admitted so far as it contains averments of fact, but not, of course, as to the averment that the tax was illegally assessed or collected.

Mr. Kane: Yes.

Mr. Pepper: The averments specifically admitted by the affidavit of defence are as follows:

"2. The defendant, Ephraim Lederer was at all times hereinafter mentioned, and still is the collector of Internal Revenue for the Eastern District of Pennsylvania, being duly commissioned as such pursuant to the laws of the United States."

"3. On or about or prior to the 30th day of April, 1914, the United States Commissioner of Internal Revenue, presuming to act by virtue of the legal authority conferred by statutes of the United States Congress, assessed against the plaintiff, as an insurance company engaged in business in Pennsylvania, an additional income tax amounting to $18,247.82 upon net income for the year 1913."

"4. The lists upon which said tax assessment appears were thereafter duly transmitted to the defendant, as collector aforesaid. The defendant thereupon made formal demand upon the plaintiff for the payment of the said tax and served upon the plaintiff
19 notice of the assessment of the said tax. A copy of the said notice is hereto annexed mark-d 'Exhibit A.'"

With Mr. Kane's permission, I will omit the reading of that and simply ask the stenographer to copy the notice into the record.

"Exhibit A" reads as follows:

"Notice of Assessment of Special Excise and Income Tax.

List for Month of ——, 1914.

United States Internal Revenue, Office of the Collector.

First District of Pa. At Philadelphia.

To Penn Mutual Life Ins. Co.
921 Chestnut St.:

You are hereby notified that an income tax under the provisions of section 2 of the Act of October 3, 1913, amounting to $18,247.82, has been assessed against you by the Commissioner of Internal Revenue and transmitted by him to me for collection. This tax is due and payable on or before *the* June 30, 1914, to the person designated below in the manner set forth on the reverse side of this notice.

Payment may be made to Collector of Internal Revenue at Philadelphia.

Or to —— ——, Collector.

Bring this notice with you."

Mr. Pepper: With Mr. Kane's permission, I will now read the fifth paragraph of the statement of claim as to which the affidavit of defence makes the following averment:

"5. The defendant admits the averments in paragraph 5 except that the assessment was excessive and illegal to the extent of $6,-865.03, which is denied for the reasons more particularly set forth in paragraphs 8 and 9 below.

20 Subject to that averment in the affidavit of defence, the fifth paragraph of the statement of claim is as follows:

"5. The plaintiff admitted liability for the said tax for the year 1913 to the extent of $11,382.79. On June 29, 1914, the plaintiff paid to the defendant the said sum of $11,382.79 admitted to be due. The said assessment was excessive and illegal to the extent of $6,-865.03. On the 29th day of June, 1914, the plaintiff paid to the defendant, in addition to the amount which it admitted to be due, the amount of the said excessive and illegal assessment, to wit, $6,-865.03, making the amount paid for the year 1913 $18,247.82. Prior to the said payment, plaintiff was informed by defendant that if plaintiff refused to pay the tax so assessed the defendant would collect the said tax by distraint and sale of the plaintiff's property. At the time of said payment plaintiff filed with the defendant a written protest, a copy of which, together with the check delivered to defendant in payment of said tax is hereto annexed marked 'Exhibit B.' The defendant gave to plaintiff a written receipt for the sum so paid, to wit, $18,247.82. A copy of the said receipts is hereto annexed marked 'Exhibit C.'"

With your Honor's permission and with Mr. Kane's consent, the same course can be taken as to those exhibits as to Exhibit A. They can be copied into the record at this point.

Exhibits B and C read as follows:

"EXHIBIT B.

The Penn Mutual Life Insurance Co., Philadelphia.

1914.
June 29.

Hon. Ephraim Lederer,
Collector of Internal Revenue,
1st District of Pennsylvania,
Philadelphia, Pa.

SIR:

21 Pursuant to the notice and demand received from you, based upon the alleged assessment of a special excise and income tax against the undersigned for the year ending the 31st of December, 1913, by the Commissioner of Internal Revenue, under the pretended authority of Section 38 of the Act of Congress, approved the 5th of August, 1909, entitled 'An Act to Provide Revenue, Equal-

ize Duties, Encourage the Industries of the United States and for other Purposes,' and of Section 2 of the Act of Congress, approved the 3d of October, 1913, entitled 'An Act to Reduce Tariff Duties and to Provide Revenue for the Government, and for other Purposes,' payment is herewith made by Check No. 35184 duly drawn on and certified by The Franklin National Bank for Eighteen Thousand, Two Hundred Forty-seven and 82/100 Dollars ($18247.82), said sum being the amount of the tax or taxes stated in said notice to be assessed. Protest is hereby made against said assessment and against the execution of said tax or taxes, and each and every part thereof, and particularly so much thereof as purports to be based upon the authority of Section 2 of the Act last mentioned, upon the ground that the same are invalid, wrongful and excessive and contrary to the rights of the undersigned under the Constitution and laws of the United States, and such payment is made solely under compulsion of said notice and demand, to avoid the seizure of the lands and goods of the undersigned and the other pains and the penalties thereby threatened.

THE PENN MUTUAL LIFE INSURANCE CO.,
By L. K. PASSMORE,
Vice-President.

The Penn Mutual Life Insurance Co.

No. 35184. Philadelphia, 6-29-1914. $18,247.82.

Pay to the order of Collector of Internal Revenue, First Dis-
22 trict of Pennsylvania, Eighteen Thousand Two Hundred Forty-seven and 82/100 Dollars
Not over Twenty Thousand $20,000$
Payable at the Franklin National Bank, Philadelphia.

M. HAMER,
Third Vice-President.
JOHN HUMPHREY,
Sec'y & Treas."

"EXHIBIT C.

No. B 848,041.

Form No. 1.

United States Internal Revenue.

Office of the Collector.

First District of Penna.,
June 27, 1914.

Received of Penn Mutual Life Insurance Co., Eighteen Thousand Two hundred Forty-seven 82/100 Dollars on account of Corporation Income Tax—1919—.....$18,247.82

(Enter here on what account paid and period of liability, "Special excise tax, 1913,' '50 per cent. penalty, R. L. D., 6 months, June 30, 1913,' 'Offer in compromise,' etc.) $.....
Five per cent. penalty.....$.....
Interest at 1 per cent. per month for — months.....$.....

Total amount paid.....$18,247.82

$18,247.82.

EPHRAIM LEDERER,
Collector.

II."

The Court: Let me inquire, Mr. Pepper. Is there any question here raised as to whether or not this was a voluntary payment?

Mr. Pepper: No, sir. The averment of payment under
23 duress is admitted, and that is really the purpose with which I have wearied your Honor by reading that long paragraph.

The sixth paragraph, which is specifically admitted, is this:

"6. On or about the 13th day of July 1914, the plaintiff filed with the defendant a claim for refund of the tax so paid insofar as it was excessive and illegal, to-wit, to the extent of $6,865.03. A copy of the said claim for refund is hereto annexed marked 'Exhibit D.' The said claim for refund was accepted by defendant."

The same course, I take it, may be followed as to Exhibit D.

"Exhibit D" reads as follows:

"STATE OF PENNSYLVANIA,
County of Philadelphia, ss:

Lincoln K. Passmore, of the City of Philadelphia in the State and County aforesaid, being duly affirmed according to law, deposes and says that he is the Vice-President of the Penn Mutual Life Insurance Company, a corporation of the State of Pennsylvania, and that the said corporation is, and since 1847 has been, engaged in the business of life insurance, and that the said corporation was assessed an Income Tax of $18,247.82, with respect to the year 1913 under the Act of Congress of October 3, 1913, which amount the said corporation on the twenty-ninth day of June, 1914, paid Ephraim Lederer, Esq., Collector of Internal Revenue for the First District of Pennsylvania, and of which $6,865.03, as this deponent verily believes, should be refunded for the following reasons, viz:

Because, to the extent of the sum last mentioned, the assessment of said Income Tax was illegal and its collection was illegal. The said sum is made up of the following items:

Tax assessed upon portions of actual premiums
24 paid back to individual policyholders in cash between March 1 and December 31, 1913.....$686,503.38
1 per cent. of said total..... $6,865.03

And this deponent now claims that by reason of the payment of the said sum of $6,865.03, the said corporation is justly entitled to have the sum of $6,865.03 refunded, and it asks and demands the same.

And this deponent further makes affirmation that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented for the refunding of the above amount or any part thereof.

LINCOLN S. PASSMORE,
Vice-President,
The Penn Mutual Life Insurance Co.

Affirmed and subscribed before me this 13th day of July, 1914.

FRANK J. REEVES,
Notary Public.

Commission expires February 21, 1916."

Mr. Pepper: Finally, the seventh paragraph of the statement of claim, which is specifically admitted, is this:

"7. After consideration of the said claim for refund of the said excessive tax assessment, the Commissioner of Internal Revenue rejected the same. Under date of June 23, 1915, the defendant sent the plaintiff a letter giving the reason for such rejection. A copy of the said letter is hereto annexed marked 'Exhibit E.' It is not true as in said letter set forth that the plaintiff had on June 23, 1915, instituted suit to recover the amount of tax involved in the
25 plaintiff's claim for refund of the said sum of $6,865.03 paid under protest for the year 1913."

"Exhibit E" reads as follows:

"Treasury Department.

Internal Revenue Service.

U. S. Post Office Building.
Philadelphia, Pa.

Office of the Collector, First District of Penna.

June 23, 1915.

Penn Mutual Life Insurance Co.,
Philadelphia, Pa.,
Legal Department.

SIRS:

I have received the following letter from the Honorable Commissioner of Internal Revenue:

'Replying to yours of the 17th instant, you are advised that the claims of the Penn Mutual Life Insurance Company of Philadelphia, Pa., for the refunding of $49,458.90, special excise taxes for the years 1911 and 1912, and $6,865.03 special excise tax paid on

account of the year 1913, are hereby rejected, for the reason that this company has instituted suit to recover the amount of taxes involved.

Receipts on Form 1 did not accompany these claims.

You will please notify claimant of this action.'

Respectfully,

E. LEDERER,
Collector."

Then follow in the statement of claim the usual averments respecting the illegality of the assessment, levy and collection, and a prayer for judgment for the amount considered to have been illegally exacted, namely, six thousand and odd dollars, with interest thereon from the date of payment, which was in June, 1914.

26 As your Honor recalls, the Act to which reference has been made, namely, the Act of October 3, 1913, was an income tax act which superseded, so far as corporations are concerned, the earlier corporation excise tax act of August, 1909. The Act of October 3, 1913, under which the question in this suit arises, was in its forms amended or superseded by an act which became operative in September of 1916, but the provisions of that later act, in so far as they touch the subject matter of this suit, are substantially identical with the provisions of the Act of 1913. Therefore, the case before your Honor is not merely a case involving the interpretation of a superseded statute, but it involves the interpretation of a statutory provision which has been continued in force, and is, therefore, of continuing importance.

The suit which your Honor is now called upon to try is, of course, in a sense, a test suit; that is to say, questions similar to this which arise for the tax year 1913, arise also with regard to subsequent years, and will continue to arise until set at rest by an authoritative decision.

The simplest course to follow in presenting the case to your Honor seems both to Mr. Kane and to me to be to dispense with any very long preliminary statement, and to put upon the stand a witness who can give specifically the facts which give rise to the question in the case.

I think we both are of the opinion, and trust your Honor will share it, that it will be much easier and simpler to discuss the application of the statutory language when we have a concrete state of facts before us, to which to apply it. So that without making any further preliminary statement I will ask Mr. Garrigues to take the stand.

Mr. Kane: Wouldn't it be well, before Mr. Garrigues begins at all, just to call his Honor's attention directly to the part of the law so that he can have it before him.

27 Mr. Pepper: Certainly.

Mr. Kane: It seems to me that will make it a little clearer.

Mr. Pepper: I will do that. All right, sir. I was going to do that as soon as we came to that point in Mr. Garrigues' testimony.

Mr. Kane: That will be all right, if we may follow that course. I think that will be all right. Excuse me for interrupting. I would rather not interrupt now. Keep right on, and when we come to it, then we can put it in.

Mr. Pepper: As soon as we came to a point where the question of the Tax Act arose, I thought I would hand that to his Honor.

Mr. Kane: That will be all right.

Mr. Pepper: If I go beyond that point without doing so, you check me up.

Mr. Kane: All right. I may have something at that time to say, too, because that is the advantage of trying a case this way.

FREDERICK H. GARRIGUES, having been duly sworn, was examined and testified as follows:

By Mr. Pepper:

Q. Mr. Garrigues, you occupy what official position in the plaintiff company?

A. I am mathematician of the Penn Mutual Life Insurance Company.

Q. And the Penn Mutual Life Insurance Company is a Pennsylvania corporation with its principal office in the City of Philadelphia?

A. Correct, sir.

Q. And you reside yourself where?

A. In the City of Philadelphia, 6806 North 11th St.

Q. How long have you held the position which you now fill?

A. Approximately, ten years.

28 Q. Does that represent the whole term of your experience in life insurance?

A. My connection with the company began in 1882.

Q. And you have successively held what positions?

A. From office boy through the ranks up to my present status.

Q. Will you tell his Honor what type of insurance company the Penn Mutual Company represents, whether it is a stock company, or whether it is a mutual company, as its name would seem to indicate?

A. The company is purely mutual in its organization, and in its conduct.

Q. There are no stockholders?

A. None whatever.

Q. And the members of the corporation are who?

A. Are policy holders. The members are the company.

Q. Will you make a brief statement to us of the characteristics of mutual life insurance as distinguished from other forms?

A. As distinguished from stock?

Q. Yes, any forms of non-mutual insurance.

A. There are other companies than the mutual, some upon a stock or proprietary basis, and some upon a mixed basis, where the policy holders have the right of participation. Under the stock company,

so-called, the earnings or savings of the company are the property of the stockholders, and dividends accrue therefrom. Under a mixed company, with a stock interest, and a mutual participation, there is usually a share in the salvage between the stockholders and policy holder, but in a mutual company, such as the Penn Mutual, without any stock interest whatever, the insurance is aimed to be sold at cost, that is the intention, and any salvage in a given year is distributed to the members, the policy holders, in the succeeding year.

Q. State whether or not the giving of insurance at cost is characteristic of mutual insurance?

29 A. That is the underlying principle of mutual insurance, that the members insure each other. The company is not separate and apart and insures no one. The members insure each other.

Q. Will you tell his Honor what the method is in accordance with which payments or contributions are collected from the members in order to meet the losses that occur? Are the collections or payments made in advance of the happening of the contingencies insured against, or subsequently?

A. In some forms of companies there are collections of premiums or cost after the ascertainment of the amount involved after the deaths have actually happened, but in companies such as the Penn Mutual there is a determination in advance of what the approximate cost of carrying a risk will be at a given age, and so on, throughout our premium table. Do you care to have me continue as to the method?

Q. Yes, if you will.

A. There is first, your Honor, an assumption of mortality, what is known now in the statutes, and there made the legal method of valuing on the company's liabilities, as the American Table of Mortality. That assumes in a given number of selected or examined lives a certain death rate. It is a table which has been made admittedly more or higher than the expectation on the theory that the mutual company, having no stock capital with which to guarantee losses, must make everything safe, beyond peradventure, in its calculations. Then an interest assumption is made, which also is very conservative. It is so small as to be with reasonable certainty almost surely attainable; as low in some states, by an enactment, and in others optional with the company, as three per cent. The companies always having earned more than that, the three per cent. is a very safe assumption. Then to the total of the net premium arrived at in this way is added an expense provision, technically called the loading, which also is supposed to be abundantly adequate to cover all risks. Now, those three factors go to make up the

30 table or office premium, which is named in policies of the members.

The Court: I would suggest, Mr. Pepper, that you put upon the record anything in the way of testimony along this line that may occur to you to put on the record, but if it is merely for the information of the Court—this Court, you may make it as short as you please, because we really can get all that information from counsel.

Mr. Kane: If Mr. Garrigues can give it to us, it will help. I have no objection to Mr. Garrigues going on. Indeed, it helps matters, in clearing the matters up. It clarifies matters, if he is allowed to go on.

Mr. Pepper: Unless it is distasteful to your Honor.

The Court: Not at all, but I thought I would just say that to you.

Mr. Pepper: My purpose is to ask a very few elementary questions, and then take up specific types of policies.

The Court: I had no thought of suggesting any change. I made the remark so that you would feel at full liberty either to amplify or concentrate what is your evidence.

Mr. Pepper: Thank you, sir. I will follow that course.

By Mr. Pepper:

Q. Then, if I correctly understand you, the premiums collected from an insured at the beginning of a policy year is a premium which takes into account three factors, among others probable mortality, probable interest returns and probable expenses.

A. Yes, sir.

Q. What happens if during the course of the year following the payment of the premium, a saving is actually effected in some one or all of these particulars?

31

A. There is an account stated at the end of each year, calendar year. After the losses and expenses of the Company have been ascertained and provided for, a statutory reserve is set aside. The account then leaves remaining a surplus, an unused or redundant premium account. That amount has been made up from the three factors that we named, or any one of them, or all, usually all, mortality less than the assumption, interest greater than the assumed rate, and a saving on the loading or expense side. Now, that surplus, then, is apportioned among the members, the policy holders of the company, in proportion to their contribution, and may be used in one of several ways.

Q. And state whether or not each policy holder's proportion of what turns out to have been excessive premium payments is returned to him either by payment or in form of credit or otherwise?

A. In each case the policy holder is entitled to his share of the surplus, his redundant premium made up in the way stated, to be used either in reduction of premiums or otherwise, as we should develop.

Q. And will you tell his Honor what the relation is in fact between the thing returned to the policy holder by credit or repayment and a premium payment previously made by him?

A. It is the unused portion of the former year's premium, if I correctly understand you.

Q. So that the portion of a premium payment which turns out to have been unnecessary or excessive is subsequently accounted for by the company to the policy holder in the way that you have indicated?

A. Yes.

Q. And will you tell us whether or not the item of excess thus

accounted for is in the language of life insurance people called a dividend?

A. It has been so misnamed from the inception of the business in this country, perhaps when it began abroad. Any salvage was called a dividend. There has been some misunderstanding for that reason.

32

By the Court:

Q. That is not an inaccurate expression, Mr. Garrigues. It is each person's share of what is divided.

A. A dividend in the mind of the layman is a commercial profit.

Q. I know, and there is the misnomer.

Mr. Pepper: Yes.

By Mr. Pepper:

Q. The point you intend to make, whether it is rightly or wrongly called, is that it is a different transaction——

A. It is a different kind of a dividend at least. It is not a commercial dividend or profit. That is the point I make.

By the Court:

Q. The thought commonly conveyed by the word "dividend," for the reason that that is the usual form of it, is that it is a sharing up of the profits?

A. The profits, yes, sir. Precisely.

Q. Undoubtedly a dividend is a sharing up of a divided thing, whether it is a profit or whether it is not a profit.

A. Or salvage.

Q. And you do have the same expression. A corporation reaches a dissolution stage, and there is a division of its assets. The word "dividend" is commonly and appropriately applied to that.

A. Yes.

Q. It is not a profit dividend.

A. That is the point I am making, your Honor.

By Mr. Pepper:

Q. Mr. Garrigues, what is the ultimate source of the income of a mutual life insurance company?

33

A. Premiums from the members.

Q. You have referred to an interest item several times. What do you mean by that?

A. That is the result of investing these premiums to mature the contracts in accordance with their terms.

Q. So that in the first instance the Company gets the premium payments from its members, and to a certain extent invests the premiums thus received, and then the interest accrues upon the investment. Is that correct?

A. Yes, that is part and parcel of the insurance system.

Q. So that in any given year the company actually receives cash or other value from the policy holders, and also collects interest on the investments made in the way you have described?

A. Yes.

Mr. Pepper: At this point, may it please your Honor, let me call your attention to the language of the Statute, which you will be called upon to construe. We direct your Honor's attention particularly to the paragraph or section indicated by a capital G, with a small a in parenthesis, which, as you see, sir, proceeds to lay an income tax upon the income of corporations.

The Court: Is that proviso affective?

Mr. Pepper: Not the first proviso, sir. The proviso to which I direct your attention you will find at the bottom of the next page. If you will turn over to page 10.

Mr. Thompson: "And life insurance companies," it begins.

Mr. Pepper: At the bottom of the page, there is a provision to the effect that "provided further, that mutual marine insurance companies"——

Mr. Kane: That is the one.

34 Mr. Pepper: That is the proviso about which the controversy centers, although there is an earlier provision.

Mr. Thompson: That part of the provision, "And life insurance companies."

Mr. Pepper: With your Honor's permission, I will read aloud that last proviso.

The Court: Tell me, Mr. Pepper, why doesn't that previous proviso have some bearing on this matter?

Mr. Pepper: It does, sir, and that is the proviso that I referred to when I said that ahead of the one to which I referred your Honor there was a provision to which reference is necessary, and that previous provision is this, that, under the head of "deductions from gross income," which companies are permitted to make, we find this provision:

"And in case of insurance companies the net addition if any required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts."

Then the proviso to which I first directed your Honor's attention, which reads:

"Provided further, that mutual marine insurance companies shall include in their return of gross income, gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy holders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof."

And then the provision specifically applicable to the plaintiff company, "and life"——

The Court: I do not want to anticipate the argument, but in order that I may follow you intelligently as you go along, I notice this is in the past tense, that "It shall have been paid back," not

35 in the perfect tense. I do not see just how that question, practically, can arise where the Company makes its return before the reimbursement to the premium payers. In other words, the general proposition, as I understand the very clear explanation that Mr. Garrigues has given us, is that what the insured pays is really an assumed maximum requirement. Now, if that maximum, as, of course, it is expected to, exceeds the actual requirement, then there is in some form or other an expectation of a refund?

Mr. Pepper: Yes, sir.

The Court: That thought is clear enough. Now, the company comes to make its return of income. It has received that money. Of course, it has received it in a very substantial sense as a trustee to reimburse it, and not only intends to, but eventually does reimburse it, but at the time the return is made it has not reached that clock time for the reimbursement to have been actually made. Does that question arise here?

Mr. Pepper: That is a statement introductory to the question that does arise, and I think your Honor's suggestion can be cleared up by a question that I will now put to Mr. Garrigues.

By Mr. Pepper:

Q. His Honor has pointed out, Mr. Garrigues, that in any given year the company under the system that you have described will receive from each policy holder this assumed maximum premium payment, the time not yet having arrived when it can be ascertained if any part of such assumed maximum is to be refunded, and if so, what part. The question that I put to you is this: Does the Company in point of fact include in its tax return for the year in which the assumed maximum is received, the full amount of such maximum premium payment?

A. The Company includes in its tax return the initial maximum premium and pays tax upon that sum.

36 Mr. Pepper: So that the story begins, may it please the Court, with the receipt in a given year by the Company from the policy holder of what you have aptly described as the assumed maximum premium payment. The Company includes that entire premium payment in its taxable income for that year, and pays the tax upon it.

The Witness: Yes, sir.

By Mr. Pepper:

Q. That is correct?

A. Yes, sir, that is correct.

Q. Then, state to his Honor whether the determination of the extent to which, if at all, the premium payments so received as excessive is arrived at by the company?

A. It is ascertained at the completion of the year, the surplus that remains after all expenses and legal liabilities are accounted for.

Q. Taking an assumed case in which, we will say, in 1912, the calendar year 1912, an assumed maximum premium of we will say

$100 is received from a policy holder by the company, and assume that the Company was making a tax return and a tax payment for 1912. What would be the amount of income from that particular source that the company would charge itself with, and upon which it would pay tax?

A. $100.00.

Q. Now, assume that at the end of 1912 a calculation were to be made showing that, let us say, ninety dollars would have been sufficient, and that $10.00 represents the saving from one or all of the factors which you have specified, mortality, interest and expense. Is that ten dollar item the thing which in the parlance of life insurance, is called a "dividend"?

A. That is the technical name for such salvage, yes.

Q. And will you tell his Honor whether it is that ten dollar item which in the subsequent year is accounted for to the insured in some way or other?

A. It is.

37 Q. Will you then tell his Honor whether the question presented in this case is the extent to which, if at all, the company is entitled to exclude from its taxable income in such second year the ten dollar item that I have indicated?

A. That is the question before the bar.

Q. Now, Mr. Garrigues, will you tell his Honor whether in the policies that are actually involved in the present case, the determination of the dividend or refund usually happens in the same tax year as the tax year in which the original premium payment was made?

A. It is very unusual. The only way practically in which the refund can be concurrent with the payment of a premium is if the payment of the premium is delayed by a temporary note, or if it is payable in instalments; for instance, half yearly or quarterly, so that some of the deferred premiums can come into what we might call the dividend year.

Q. Under ordinary circumstances the premium payment is in the first instance made in one tax year, and the determination of the amount refundable to the policy holder is made in the subsequent tax year?

A. The determination and the actual refund are made in the subsequent year.

The Court: Does that have a bearing upon "within such year"?

Mr. Pepper: Yes, sir, precisely. Your Honor has put your finger now, as I hoped you would do, upon what is really the controverted question.

The Court: All right.

Mr. Pepper: Because, as your Honor will see, the words "within such year," with which that proviso concludes, are words which, as we contend, qualify only the time of the transaction of crediting or repaying to the insured the amount of his previous excess payment, whereas, according to the contention of the defendant

38 the words "within such year" are to be carried back as qualifying the transaction of the original receipt. So that the

question, from the point of view of the defendant, whether or not an exclusion of the taxable income was to take place in a given year depends upon what we would regard as the accident of whether or not the original payment was made within or without the limits of the year. That is as accurate a general statement as I can make of it, although, as I speak, there are various qualifications that come into one's mind that will have to be taken up one by one.

By Mr. Pepper:

Q. Now, Mr. Garrigues, we have presented to his Honor a general statement of the character of the business that this plaintiff does and of the facts in outline as affected by this statute. I want to begin now a series of questions designed to get upon the record the exact facts respecting each of the different types of policy transactions which are in fact involved in the present case. Before I take up those different types of policy contracts one by one, I am going to ask one group of preliminary questions. Assume the case that I put to you a few minutes ago of a premium payment of $100 made in 1912, an ascertainment at the end of the year that ten dollars of such payment was unnecessary, and that, therefore, in 1913, the insured becomes entitled to some kind of a refund. Will you tell his Honor whether or not it often happens that the insured uses the credit thus coming to him for the purpose of reducing or abating the premium payment called for by his policy for 1913?

A. That is very commonly done. It is the usual practice, in, I should say, from half to two-thirds of the cases.

By the Court:

Q. They need the money?

A. Yes.

39 By Mr. Pepper:

Q. They need the money?

A. Yes.

Q. And the effect of using the credit in the way just stated is to enable the insured to pay $90.00 in cash for 1913, instead of $100. Is that so?

A. Yes.

Q. Will you tell us once more whether in the suppositious case the full $100 was returned and taxed in 1912?

A. Yes, $100 the first of the year.

Q. Then, in 1913, the question will arise whether the taxable income of the Company, so far as this particular transaction is concerned, is $100, made up of $90.00 cash payment, and $10.00, credit, or redundant premium, or whether the taxable income in 1913 is merely $90.00. That question arises, does it not?

A. It does. The amount received by the Company is $90.00. If I may amplify that; the receipts of the Company specify first the maximum premium, then the share of surplus, and a subtraction is made, and the final line says "cash required," in this case $90.00.

Mr. Pepper: I have called that a preliminary question because it so happens that this action does not involve the question that I have last put to the witness, and the reason it does not is two-fold. In the first place, because that question was thrashed out, as your Honor recalls, in a judicial decision under the Excise Tax of 1909, where the controversy arose between the Government and the companies as to whether these dividends used in abatement of subsequent premiums were taxable in the second years, and it was decided in the case to which your Honor will be given a reference that they were not taxable in the second year. Thereupon the Congress in passing the Act which is now under interpretation here seem to take account of the decision in the Herold vs. Mutual Benefit Case,
40 and in the other proviso, to which your Honor's attention has been called, inserted this language, "And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policy holder as shall have been paid back or credited to such individual policy holder;" then the clause to which I particularly call attention, "or treated as an abatement of premium of such individual policy holder within such year."

In deference to the plain language of the statute, the Government concedes that in such a transaction as the witness has last described, the amount used by the insured in reduction or abatement of his premium payment in 1913 resulting from his previous overpayment in 1912 is not a taxable item, and the plaintiff was not compelled to pay a tax in respect to such item or the aggregate of such items.

The Court: Mr. Pepper, I do not yet get clearly in my mind whether there is a difference between you upon this sort of a differentiation. A policy holder receives from a company his premium notice. That sets forth the amount of his premium on the estimated maximum basis. It sets forth a credit of which he may avail himself in a number of ways. One way in which he may avail himself of it is to treat it as if he had already paid that amount upon his estimated premium requirement, and was, therefore, merely called upon to pay the balance remaining, or he may ignore that option altogether, and pay the whole amount of the estimated maximum premium, in which event, of course, he is compensated by an accretion to the amount which is ultimately paid to him when his policy becomes payable. Does that differentiation enter into this case, between the man who avails himself of the optional credit, and the man
41 who appropriates that credit to the payment of his premium, but what is to all intents and purposes the purchase of additional insurance?

Mr. Pepper: That differentiation does enter into the case. The purchase of additional insurance with that additional credit is one of the uses to which the insured may put his credit. There are a great many others, but let me say this, sir, that where the transaction takes the simple form that has been indicated in the questions and answers just put to the witness, namely, the application in the tax year of 1913 of the reundant premium or dividend to the reduction of the 1913 premium, there is no difference between us. It is con-

ceded all round that the item in that case is not to be included in the taxable income in the second year, in 1913. I can go a step further, I think. Mr. Kane will correct me if I am wrong. I think it is further conceded that even if in 1913 the process of paying the premium for that year, and the drawing down in cash of the ten dollars are not actually coincident in date, or cotemporaneous, that, nevertheless the substance of the transaction being the payment of $90.00 by the insured instead of $100, the full $100 having been taxed in the previous year, the Company is not required to include that item, that $10.00 item in the 1913 income, but at that point the ways begin to diverge. Mr. Garrigues will correct me presently if I am mistaken, but I understand that it is precisely there at which the ways begin to diverge, because if it were to happen that in the hands of the company at the beginning of 1913 there were excessive premium payments not previously withdrawn, and amounting, let us say, to forty dollars, instead of ten dollars, and that in 1913 the insured paid $90.00 and used only $10.00 in abatement or reduction of his premium, and at some time in the year drew down in cash the other $30.00, it would be contended by the government that
42 the Company had no right to exclude from its taxable income in 1913 those payments in excess of the $10.00, not used in abatement of premium and refunded to the insured in cash.

By Mr. Pepper:

Q. Such cases are among those, are they not?
A. There are such cases.
Q. Included in these alleged excessive payments?
A. There are cases of that nature, yes, sir.

Mr. Pepper: Then, of course, may it please the Court, that being the next nearest to the simple case of the dividend used in abatement of the premium, we begin to advance to the more complicated cases which his Honor's mind has touched in advance, namely, cases in which redundant premiums are neither used in abatement, nor are they withdrawn in cash, but are left with the company under the terms of the policy contracts, which provide various sorts of optional uses for them.

The Court: Do you differ on that proposition?

Mr. Pepper: We differ on every proposition except the simple case of the use of the entire redundant premium in the tax year to pay the premium for that year.

Mr. Kane: Yes.

The Court: Your illustration of the forty dollars; did you mean forty dollars, or did you mean forty dollars in the sense of the accumulation of four ten dollar premiums?

Mr. Pepper: That is what I meant, yes, sir. Four ten dollar annual savings.

The Court: I interpreted it in that sense, but I wanted to make sure.

43 Mr. Pepper: That was the sense in which I intended to use it.

By Mr. Pepper:

Q. Now, Mr. Garrigues, I have expressed somewhat lamely the transaction which follows next in order after the transaction in which a redundant premium is used in abatement of a succeeding premium. Can you give to his Honor a specific illustration of the kind of transaction that I have attempted to describe, namely, one in which the credit of the insured is used partly in reduction of a premium payment for the tax year 1913 and is partly drawn down in cash.

A. I am afraid I have here only the more intricate cases. The very simple case, such as you said, where the insured says to the company he does not want the dividend to come yet——

By the Court:

Q. You may give us a supposititious case. That will illustrate it. You need not give an actual case.

A. We have policies whereunder there is an interest option, as we call it. The insured may leave with the company his surplus dividends from year to year to be accumulated by the contract at a stipulated rate of three per cent. I would just say incidentally that the Board adds practically the balance of the net interest earned, namely, another one and a half per cent. The fact is that four and a half per cent. is paid, and that has been done for a number of years. Now, that practice may continue for a series of years, and the insured may withdraw a single year's surplus, or he may withdraw his entire accumulation to date, and that is what we know then as a dividend paid in cash, and that is, perhaps, the simplest item that comes within that picture after we have passed over the abatement.

By Mr. Pepper:

Q. So that that is the case in which the aggregate of the
44 prior excess payments is applied by the insured in part in abatement of the premium for the tax year and in part is drawn down in cash by him.

A. If that is concurrent with the payment of the premium, then your statement is correct, or if it would be within the policy year, any time within his anniversary year, it would be a full cash payment.

Q. In the first place, may the case arise in such a transaction as you have been describing in which coincident with the payment of the premium for the tax year, the insured uses some of his accumulation to reduce the premium, and some of it by way of a cash payment from the company? May that case arise?

A. Yes. If there had been an accumulation of a few years, three, four or five, and the insured at his anniversary said, "I want to get my insurance as cheaply as possible," instead of leaving his current surplus for that year to accumulate, he would have used it in the abatement of the premium.

Q. That is, the whole accumulation?

A. Merely the last year.

Q. Merely the last year?

A. Yes. In that case, if we assume this to be ten dollars, that would be deductable as an abatement in making up the tax return, but the other man, if it kept on accumulating to thirty or forty dollars, that would be refunded to the insured as a cash payment, and that appears in our statement here of dividends paid in cash, the point at issue.

By the Court:

Q. Let me get that clearly. The impression I get from that is that his payment, then, does not figure in your tax return; that is, you do not reduce your tax payment by reason of that payment, or do you?

A. Perhaps I will have to go back a little bit and say that when these premiums are paid through an assumed period of five years, when the $100 appears on the income for each year, the company returns to the Government a tax upon it, but when we come to settle with the insured, if he draws down this accumulation on his premium anniversary, when he is settling a premium, the credit for that last year is used in abatement of the premium, and the balance is considered as a cash dividend. If, however, the party comes there, if he has paid his five $100, and he comes along a day, a week, or a month later, and says, "I want all of it," then the whole of it is a cash dividend, and it so appears in our statement.

By Mr. Pepper:

Q. And is this the fact, that where the transaction takes the first of those two forms, the portion of the redundant premium used in abatement of premium for the tax year is confessedly not taxable, but the balance of the accumulation drawn down by the insured in cash is contended by you to be likewise not taxable, but by the Government to be taxable?

A. That is the situation.

Q. And is it likewise true that where the drawing down of the accumulation is not co-incident in date with the payment of the 1913 premium, but takes place subsequently, that that entire payment, then, is reported by you among your dividends paid in cash, and is contended by you to be properly excluded from your taxable income for 1913, and is contended by the Government to be necessarily involved in it?

A. That is correct. We contend that that is free of tax, or should be as though it had been taken annually.

By the Court:

Q. Mr. Garrigues, take first the case of the payment of what we have called the maximum estimated premium, and upon a comparison of the actual needs there is ten dollars, we will assume, of that left. When the next premium payment comes the man exercises his option to apply that ten dollars to a reduction of his then

estimated maximum premium, and he pays to you merely
46 the difference. Now, then, as I understand you, in the tax liability assumption you have made, you claim that that ten dollars is not income?

A. Yes, sir. That is conceded in the Herold case.

Q. I understand that. Take the case where a man has not used those dividends for subsequent years, we will say one, two, three and four, so that there has been an accumulation of a deposit fund, as we may call it, with you, amounting to $40.00. The man continues to pay his full estimated maximum premium. Then you call his whole premium payment as an income upon which you are willing to pay a tax?

A. We have that $100 once each year. Yes.

The Court: I understand.

Mr. Pepper: That brings it out beautifully, may it please the court.

By the Court:

Q. Then, the fourth case. The fifth case, really. I will take the fourth case. Let that run on until the supposititious accumulation is forty dollars. Then comes another year, which, if the same plan was pursued by the policy holder, would increase his accumulation to fifty dollars, but in that year he asks for a reduction, not of the whole fifty dollars, but of the ten dollars which is the annual accumulation, and you claim, I assume, the right to deduct that ten dollars from your premium income of that year?

A. The law says we may exclude it.

Q. Now, take that same state of facts, but the man, instead of doing only what I have indicated, does in addition this; he makes a demand upon you for forty dollars in cash. He applies ten dollars to a reduction of the premium payment, and asks you to pay him the forty dollars in cash. As I understand you, you would then claim the right to deduct the ten dollars, but would recognize that the forty dollars was a real dividend payment, and would not deduct that from that year's premium receipts. Is that right?

47 A. There is a peculiarity of language of this Act which——

Q. I only want to get an answer to that question.

Mr. Pepper: The answer is "no."

The Court: Then, of course, the same thing would be true—if it were true as to the whole of it, the same thing would be true from your point of view, whether he deducted the whole amount, or whether he deducted any portion of it, after you get above the ten dollars, which is properly appropriated to that transaction of that year.

Mr. Kane: Yes.

The Witness: Perhaps it would simplify it a little bit if we take five gross premiums, and then say here are four or five dividends applied later in abatement, or paid in cash. Set one against the other. We have not done it annually. The man then exercises his option to wait, and then he pays it in the tax year.

By the Court:

Q. Let us put that concrete case. Take this sort of a transaction. There are four ten accumulative premiums, wherever that deposit is made, and the current year adds another ten dollars, so that when he comes to pay the succeeding year's premium in advance, he has fifty dollars really in your hands. Now, we will take the case in which he asks you to apply the whole fifty dollars to the reduction of his premium. Do you claim that that whole fifty dollars is to be deducted from your premium income receipts, or do you claim that only ten dollars of it is properly deductible?

A. We claim the entire amount in the last analysis, but as an abatement $40.00, as a cash dividend, the accumulation of other years.

48 Mr. Pepper: That would be conceded by the Government, too, that wherever the whole of the redundant premium payment is used in fact in reduction of the premium for the second year, or the subsequent year——

Mr. Thompson: I do not think so.

Mr. Kane: No, sir.

The Court: I do not see how they can concede that.

Mr. Kane: We could not.

By the Court:

Q. Let me put it this way. From the point of view of the claim made by your company, with which I assume, yau are, of course, familiar, you make a distinction between those two kinds of cases. Assuming, as we have before assumed, four annual ten dollar accumulations, and one current ten dollar accumulation, and the time arrived at which the man is to pay his advance premium for the next year. You have two policy holders in precisely that situation. One of them comes to you and says "Here is my premium less ten dollars, but I want my other forty dollars in cash," and you pay it to him. The other man says, "Here is my premium less the fifty dollars that you have, and I want a receipt for the payment of my premium." Do you make any distinction on your tax return between those two stock holders?

A. We are obliged to under the language of the Act.

Q. I am not asking you that, but I am asking you what you do, what you have done as a practice.

A. That is the same practice. Here it is. If a man comes with his premium at his anniversary and uses ten dollars in abatement of the premium, that is, under the Act, allowed as an exclusion, as a deduction, to arrive at the gross income. Then, the insured executes a surrender of his surplus and deposit with the Company, and that we take credit for under another section of the Act, which allows
49 a deduction of dividends paid in cash. Doesn't that answer the question?

Q. It does in part. You see, there is a transaction which is substantially the same. In each case each man has withdrawn his whole deposit from the company. Now, one has withdrawn it in the form

of a credit for the whole amount. The other has really done the same thing, because he has paid his premium in cash, and is asking you for part of it back.

A. So far as the net receipts of the company are concerned, they are identical. There is no question about that in the world.

Q. But the form is different?

A. The form is different.

Q. And I assume the bookkeeping records are necessarily different?

A. Yes, and the law.

Q. What I want to know is, do you make a distinction in your tax return between those two men with respect to your premium receipts of income?

A. I do not know how I can make it clearer, your Honor. Where a man has an abatement the law allows us to report that in a certain way, and we bookkeep it in a certain way. For matters of correct bookkeeping, a company such as ours, for each year, shows the gross income of a given case. In the total premiums it will have in such a case as we have cited ninety dollars as premium receipts and ten dollars as dividends used in the payment of premiums on the income side. Then it will have a disbursement upon that premium of ten dollars. So that the balance will be what the company actually receives, income, $90.00.

By Mr. Pepper:

Q. Mr Garrigues, recurring to his Honor's question, the form of your return is determined by whom? By the officers of the Company, or by the Government?

A. By the language of the Act and the Government's blanks.

50 Q. And that form is so drawn as to make a distinction between the two types of transactions that his Honor has indicated?

A. Yes, sir, exactly.

Q. Therefore, the answer to his Honor's question is that following the Government's form of return, you do make a distinction between the case in which some of the credit of the policy holder is used in abatement of the premium, and the case in which none of the credit of the policy holder is so used?

A. Yes.

Q. And that distinction is made on your return in deference to the requirement of the form?

A. Of the Government, yes.

Q. With regard to your contention, respecting what constitutes taxable income, is it a fact that you treat, or would desire to treat, both of those transactions alike and exclude from the taxable income the whole amount paid back to the policy holder or credited to him, whether or not any part of it is used in abatement of a premium?

A. We would like to treat them similarly, and when we make our return the effect is the same, because we exclude from the gross income the abatements and deduct the dividends paid in cash, whatever the balance is, so that in arriving at out net, we meet precisely similarly.

Q. To make this clear to his Honor, if it is not clear already, the original premium payments, of which a portion is refunded to the insured in the way that you have stated, were all included in the taxable income in the year of their receipt, and a tax paid on them in full. That is correct, is it not?

A. Yes, sir. Gross premiums.

Mr. Kane: How about interest?

Mr. Pepper: I was going to ask him about that.

Mr. Kane: We might as well meet that now.

By Mr. Pepper:

51 Q. In the case in which an interval of years has occurred between the date of the original premium payment and the date of the refund to the insured in one way or another, as you have described, state whether or not interest at a certain rate has been included in the accumulation of the policy holder's money?

A. Yes, any dividend left with the Company bears interest as the interest accumulates.

Q. And that is in accordance with the policy contract?

A. Yes, sir.

Mr. Kane: Is that true within the year? Does it ever arise within the year?

By Mr. Kane:

Q. Is that true of fractional parts of a year, or can it arise within a year? It is always a year, is it not?

A. It usually is a year. Some of our contracts provide that they shall have interest at fractional periods, but usually it is per annum.

By Mr. Pepper:

Q. Will you tell us whether or not the interest accretions which are credited to the policy holder year after year in the interval under the supposition are deducted by the Company from the taxable income on the payments made under policy or annuity contracts?

A. They have been included in the total of the dividends paid, yes.

Q. And the company claims to deduct the interest items as payments made under the policy contracts?

A. That is the contention, yes.

Q. In regard to the other matter indicated by Mr. Kane's question, you have explained that in the dividend or redundant premium there is an interest item of saving within the year?

A. Yes.

52 Q. State whether or not the interest accruing to the Company on its investment within the year is an item on which the company pays taxes as part of its income for that year?

A. That is included in the gross income.

Q. So that as to the interest factor entering into the redundant

premium, the Company pays taxes on that as part of its income for that year?

A. It is included in the gross income.

Q. And with regard to the interest accretions during the years between the receipt of the redundant payment and the ultimate accounting, the Company claims the right to deduct those from the taxable income when finally paid as being payments made under a policy or annuity contract?

A. Yes.

Q. Under the language of the Act?

A. Yes.

By Mr. Kane:

Q. To make that perfectly plain, is there any redundant premium money in the possession of the company, on which interest is eventually paid to the policy holder where the interest did not appear as the interest on the investment of the Company?

A. Oh, no, because the dividends left with the company, whatever may be their nature, form a portion of the invested assets of the Company from which interest is derived; one naturally comprehends the other.

Q. So that every item of interest that is paid the policy holder is actually reflected in the interest upon the company's moneys?

A. Correct, sir.

Q. And, therefore, at one time or another, would pay a tax?

A. It is included in the gross income for the taxable year, yes, sir.

53 The Court: This thought just occurred to me. These companies partake of a dual character or nature. They are insurance companies and they are saving fund deposit companies. That is substantially what they become. They do both. They insure their policy holder against the contingency of death, and they receive deposits from their policy holders and allow them practically—that is what they do allow them—interest on their deposits just the same as any saving fund does.

Mr. Pepper: They have that dual character, and if they were only saving funds, without capital stock, they would be exempt from taxation altogether, under the Act.

Mr. Kane: That is perfectly true, but, of course, they are not.

Mr. Pepper: I am simply carrying out your Honor's thought, that in so far as the saving fund business is incorporated into or engrafted upon the insurance business, it is a type of business which Congress recognizes as one which ought to escape taxation.

The Court: Let us separate them. Say a policy holder, instead of drawing out his ten dollars, the policy holder does not intend to use it.

Mr. Pepper: Yes, sir.

The Court: He says to them, "Deposit that to my credit in the saving fund across the street." Now, he comes the next time. He can draw his check on that saving fund and pay his premium if he chooses.

Mr. Pepper: Yes, sir.

The Court: Or he need not do it, if he so prefers. Now, is the insurance company affected by the fact of whether he pays his premium out of that fund, or whether he pays it out of his trouser's pocket fund?

54 Mr. Pepper: The insurance company is not affected, sir, if at the time the credit is given to him, whether on the books of the company or by actually putting the money in a deposit account across the street, the company is permitted to deduct the amount of credit from its taxable income in that year on the theory that the item for which it has thus accounted, is precisely the same item on which it has paid a tax in the previous or still more remote year. Your Honor, as the children say in the Christmas game, is getting warmer all the time, because you come closer and closer with each question to what I conceive to be the ultimate controversy in the case.

The Court: A double taxation proposition?

Mr. Pepper: It is the double taxation proposition, and the conflict between an interpretation of the Act which we contend enables the Company to avoid the consequences of double taxation by an adjustment in subsequent years of an excessive payment previously made, and the contention of the Government, which is that the whole thing is to take place within the limits of the year, and has to be incidental to a receipt of premiums from the policy holder whose case is in issue.

The Court: That is the stage to which my mind has arrived.

Mr. Kane: Of course, we are guided by the words of the Act of Congress.

The Court: I know, but that puts it very fairly.

Mr. Kane: We cannot read into the Act any avoidance of double taxation, if such there be.

The Court: That brings up squarely the question. That is stated, not accurately, but substantially. Are we to take an interpretation which results in double taxation, or are we permitted to

55 accept an interpretation which avoids double taxation?

Mr. Pepper: That is our contention, that this revenue act should be construed, if compatible with its fair intent, in such a way as to avoid double taxation.

The Court: Of course, that does not affect in any way, as I understand it, your position, Mr. Kane, because your answer to that is that the Act does not permit of that interpretation.

Mr. Pepper: That is it. It is a question as to whether the Government is reluctantly compelled to accept two taxes by the action of Congress, or whether it is not.

By Mr. Pepper:

Q. May I ask you to take up seriatim the different types of policy transactions which are involved in this suit, producing in each case a policy of the sort of which you will be speaking? Would the next case in the order of simplicity be the case of so-called final dividend?

A. I presume so. That was the one I was thinking of taking first.

Q. Will you explain to his Honor what kind of a transaction is indicated by the term "final dividend"?

A. There is this term in our schedule summarized on the sheet which is before your Honor, "final dividend." Those are the dividends first upon the policies which have completed their premium period. For instance, a limited payment life, a ten payment life. The tenth premium is paid in that case one day, we will say, after the completion of the ninth year, but the surplus is not ascertained until the completion of ten years, and it is paid to the insured at the beginning, we will say, of the eleventh year, that is, the completion of the tenth year. That can also relate to endowment policies, which are completing their term, maturing. It can
56 also relate to what are known as post mortem dividends, where the policy holder dies within a year, and gets a dividend for the lapse of time up to the date of his death. Those three or four are, I think, the general cases covering final dividends, and in each case cash dividends.

By Mr. Kane:

Q. Would you mind, as you go along, if you have the little chart in front of you, point out where is the post mortem on it?

A. It occurs within this group called "final dividends," where it is discussed in one group. It is embraced within that group.

By Mr. Pepper:

Q. Now, go on from there.

A. Shall we take "full paid dividends"?

Q. "Full paid dividends" belongs in another type?

A. Yes.

Q. A typical class?

A. Yes, sir.

Q. Let us confine our attentions to the "final dividend" for a moment. Suppose that in 1912 occurs the last of the stipulated premium payments; then in 1913 there may be a payment in the way you have described to the insured by way of a dividend. Is it not so?

A. Yes, an accumulation of the former year.

Q. Would you explain to the Court just what relation the payment made in 1913 by way of a dividend to the insured bears to his previous premium payments?

A. It is the redundant portion of the former year's premium and it equalizes to the insured member the dividend he failed to get the first year.

Q. So that it is really an extension to a slightly more complicated state of facts of the simple transaction that you have in the first instance described to the Court?

A. Yes, sir.

57 By Mr. Kane:

Q. In other words, do we understand that the deferred dividends for the ten year period, of accumulations, then are paid?

A. No, these are annual dividends, the cases we are speaking of now. We have not come to the deferred dividend groups yet. This simply goes to the annual dividends where the final share of surplus is paid.

Q. The final is deferred until after?

A. Yes. This is merely covering the last year that lapsed.

Q. So that there would be no annual payment of premium at all in that year?

A. Correct. Yes.

By Mr. Pepper:

Q. That point I want you particularly, Mr. Garrigues, to bring to the attention of the Court. In the cases you have heretofore discussed, in every instance the credit or repayment to the insured has taken place during a year in which the insured was paying a premium to the company. Is it not so?

A. We have so assumed, yes, sir.

Q. We come now to a case in which the insured has in the year previous to the tax year made the last of his stipulated premium payments; so that in the tax year under discussion the insured receives what you describe as a final dividend?

A. Yes.

Q. But himself makes no payment?

A. He has paid no premium within that year.

Q. To the company?

A. To the company.

Mr. Pepper: I make that point for the reason that will be obvious to your Honor. It is another point of contention between us and the Government. I may say that our contention is that the tax Act lays a tax on the income of the Company as a whole and not a tax on each item of the income derived by the Company from
58 these policy holders. It is immaterial, therefore, whether for the purpose of a credit or exclusion from taxable income under the Act any particular source of income contributes to the income for the tax year. The Government will contend that unless there is a source of income during the year from the policy holder who is credited or repaid in that year, that there can be no exclusion from the taxable income.

By Mr. Pepper:

Q. The elements entering into the final dividend are the same, are they not, as those which you have already referred to, namely, savings in interest, mortality and expense?

A. Just the same.

Q. Is it a fact that the final dividend transaction is typical of a number of transactions in fact included in the disputed items in suit?

A. Yes. The sum total here involved is something over $84,000.

Mr. Pepper: What I am trying to do is to take sample bricks out of each pile as we go along.

By Mr. Kane:

Q. When you speak of $84,000, you are speaking of the total for the entire year, are you not?

A. I would like to correct that, Mr. Stenographer. That is a trifle over $74,000 for the ten months.

Mr. Kane: In other words, as I understand it, this is for the ten months subject to the 1913 law.

Mr. Pepper: Yes, sir.

Mr. Kane: The scheme of taxation.

The Witness: Thank you for the correction.

By Mr. Pepper:

Q. Will you proceed with the next typical transaction?

59 A. The next group, then, is the one immediately following, called "full paid dividends." Those are cases of limited payment lives similar to the group that enter the first, in the classification immediately preceding. A ten payment life, for instance, but these accumulations arise from the fact that the surplus accrues to this policy holder after his policy had become full paid, in the eleventh, twelfth, or some succeeding year. A twenty payment life, the twenty-first, twenty-second, or some succeeding year. The dividends are fully paid on the policies after the completion of their periods. In this case, for ten months, not quite $15,000.

Q. State what relation exists between these allowances of dividend payments to the insured after the policy has become a paid-up policy, and the premium payments previously made while the premiums were being paid?

A. The dividend which accrues on a full paid policy after the premium period has elapsed is due to redundant premiums theretofore paid. They are derived, however, from only two elements, an ordinary withdrawn dividend, as we have shown from the mortality salvage, the excess interest, and the saving in loading.

Q. "Loading" being an expense?

A. An expense, "loading." In the case now under review, as there are no premiums payable, there is no salvage from the expense item which is involved in the premium. In other words, the elements which go into the making of such a dividend as that now being considered are salvages in mortality and excess interest over the contract assumption.

Q. With the exception of the expense item, the elements entering into the dividend are the same?

A. Are the same, yes.

Q. And these dividends, as I understand you, are portions of excessive premiums previously paid?

A. They are due to redundant premiums.

Q. Mr. Garrigues, is it true in the case of the final divi-

60 dend and the paid-up dividend alike, that the Company has during the years of the premium payments included in each year the full amount of the premium paid, and paid tax upon it?

A. Such a policy could have been on a deferred dividend policy,

but if the abatement which had been ascertained to be due to the insured during the premium period had been used in reduction, then, you see, merely the net would have been reported to the Government. There could be every kind.

Q. Under this typical case that we are discussing two different situations may arise—may it not be so—one in which the redundant premium has been used in part in reduction of a subsequent premium, and the case in which it has not been so used. Is that correct?

A. Yes. We cannot tell, of course, what the mortality salvage is going to be in a case where a man has, for instance, a ten payment life policy who may live for twenty or thirty years. When the Company determines the surplus due to that gentleman during his premium paying period, it is on a certain assumption. Now, then, if the group has a more favorable mortality than was anticipated, there is a further source of surplus which goes to the insured later. I do not know whether you care to have me elaborate on those points, but I have them pretty well in my mind.

Q. I think we had better have it. His Honor has been very patient with us. I think I would like to get that on the record.

A. Then, your Honor, if the Company could know absolutely what the mortality would be in a given case or group of cases during the lives of such members, it would be unnecessary, except for the statute, to reserve on so high a basis. I mean by that to put up such a large premium. If the mortality, instead of being according to the tabular, 100 per cent., if a company could know that during
the period or of the life of the period of all of these policies
61 it were only 70 per cent., or could only go to 70 per cent.,
then, as I say, except for the statute, which specifies how this must be done, we could assume, or the Company could assume a 70 per cent. mortality, which would be the exact truth. We are making that assumption, to start with. If that were the case there would be no redundant or excess premiums from any source. There would be no mortality salvage, because we would know in advance what the mortality was going to be and we would only charge what it actually was. Of course, then there would be nothing taxable as mortality salvage, because we would have charged during the entire period the exact cost of carrying the risk. So also if a company was sure throughout its history to earn four and a half or five per cent., any set rate, which it could be determined would be earned, then, why the necessity to stipulate a reserve of three per cent? In other words, the reserve would be very much lower, because earning a higher rate of interest, determined in advance, less would be charged in the premiums for that risk. The answer would be that in that case there would be no excess interest for surplus, there would be no redundant dividend of that character, and, therefore, nothing taxable from that source. So also with loading. If a company could know in advance that throughout its entire history the exact expense year by year, that it was going to be a certain sum, it would not charge a dedundant expense loading; it would charge the exact figure. Therefore, there would be no expense margin for surplus, and if wo could take all of those factors on this assumption, there

would be no dividend, no surplus, no abatement to credit to the insured. We would be paid the exact cost year after year. That is what we try to do, at any rate. But the point I am trying to make is, if we could know in advance, if our foresight was as good as our hind sight, we could take the entire period, and bring it down to an exact calculation. There would be no redundant premiums, nothing to refund, nothing taxable.

62 Q. So that this controversy grows out of the attempted adjustment of equities between the insured and his associates growing out of the fact that you cannot make this accurate assumption in advance?

A. We cannot do it in advance. It must be made later.

Q. And what you have said is applicable to the case of the final dividends and the paid-up dividends?

A. Yes.

Q. As well as to the simpler types of cases?

A. Yes, sir.

Q. Let me ask you this question. In a portion of the Act to which his Honor called attention a while ago, it is provided that the Company may make certain deductions from gross income and among others a deduction for sums other than dividends paid under policy and annuity contracts. Will you explain, if it needs explanation, the relation of that language on the subject of deductions and the language in the final proviso, which, as far as life insurance companies are concerned, is couched in terms of exclusion. What does that mean?

Mr. Kane: I object to that as calling for construction of the Act by the witness.

The Court: I do not so understand the purport of the question.

Mr. Kane: I have no objection to your modifying the question.

The Court: I will overrule the objection and allow the question, understanding its real purport to be that the witness shall enlighten us as to the fact conditions to which the language of the Act is applicable.

(Exception noted for the defendant, by direction of the Court.)

By Mr. Pepper:

Q. I meant just what his Honor has indicated much better than I did, namely, what is the difference, not in the statutory
63 construction, but in practice between the process of deducting things from gross income and excluding things from gross income?

A. In effect, the same. You ask for the construction of the payment?

Q. No.

By the Court:

Q. You mean in mathematical results they are the same?

A. Yes.

PENN M

of course, is true. But the question is now in practice
Q. Which, of difference be traced in what you do?
how can that diff

Pepper:

By Mr. P words, that is the difference between a deduction and
Q. In other wo making up your books or your returns or any other
an exclusion in n
documents? y place in which this question arises is in the actual
A. The only return to the Government.
making of the re what I want you to explain. What do you do there
Q. That is wh your return?
in making up yo g our return, first, we enter the gross income of the
A. In making h includes all premiums and all interest, any profits,
Company which me down to the last dollar. Then, the Act says that
the entire incom rtain dividends, mainly those used in the abatement
you exclude cert and the blank designates the gross income. From
of premiums, an determined the running expenses of the Company,
this amount so to policy holders, such as death claims, matured en-
the payments to render values, dividends, unused payments, are de-
dowments, surre to the growth of the Company's reserve for outstanding
ductible, as also ts, and perhaps a few other items. We get then to the
contracts, taxes, a
taxable income. rigues, I want again to direct your attention to the
Q. Mr. Garrig n. Are you correct in saying that the dividends to
form of return. are treated like your losses and payments under
policy holders annuity contracts, which are deducted. Are not the
policy and annu ds excluded?
dividends would like to correct that, Mr. Stenographer, to say
64 A. I w cludes the payments to policy holders, death claims,
that inclu yments, surrender values, and annuities, and excludes
matured endown because they are in the other category.
the dividends, be excluded under the final proviso?
Q. They are e
A. Yes, sir.

Mr. Pepper: I I asked those questions, sir, for a purpose that is
obvious to you. The first impression that one's mind gets in reading
somehow or other when you say you can deduct from
the Act is that s payments other than dividends, that that means divi-
gross income pa essarily included in taxable income, but when you
dends are neces the final proviso you find that life insurance companies
come down to th exclude even from gross income the things which
are directed to as dividends and used, according to the Government,
are described as of premiums, and according to our contention, in any
in abatement of at are to be specified.
of the ways that Yes.
Mr. Kane: Y

Pepper:

By Mr. P er statement you made incidentally, Mr. Garrigues,
Q. One other of your answer, which I think ought to be cleared up,
in the course of the record. You used the term "profits." You spoke
for the sake of t retions, and redundant premiums, and so on, and then
of interest accret

I think you said something like this, "any profits" or "profit items." Will you, if that needs an explanation, state what you meant in using that term?

A. I meant income items derived, for instance, from the sale of a bond bought at dicount or sold at premium, if bought at par.

Q. Are there any life insurance transactions as such in which your company is engaged which yield a profit?

A. None whatever.

Q. You have been good enough to take up two of these typical cases, the case of the final dividend, and the case of the paid-
65 up dividend. Are you able to produce the forms of policy applicable to those cases?

A. They are here.

Mr. Pepper: With your Honor's permission, I will ask the District Attorney what he thinks is the best way for the purposes of the record, to handle these policies. It seems to me it is unnecessary to have them copied into the record.

Mr. Kane: I should think so.

Mr. Pepper: We can supply a sufficient number of the policy forms themselves, which can be bound up, perhaps, as exhibits to the record.

Mr. Kane: That would be better. His Honor might want to look at them. We could easily direct his attention to the material parts of the exhibits.

The Witness: I only want to mention one thing, that in some of the old forms, it is doubtful whether we would have several copies. It is doubtful as to whether they have been kept. The current forms, of course, we would have an indefinite number of them.

Mr. Pepper: We will cross that bridge when we come to it. Let us say, then, that we will, with his Honor's permission, file with the stenographer the policy forms for the use of the court, and if hereafter we want to manifold them, we will have photographs made of them, or possibly we will print them.

By Mr. Pepper:

Q. Have you produced a form of policy under which the so-called final dividend question may arise?

A. Yes. I have here three forms under all of which the surplus might accrue, the limited payment life endowment, also the ordinary life.

Q. And may the question of a paid-up dividend arise in reference to any of these cases?

66 A. With relation to the limited payment life, yes.

Q. For the sake of clearness, will you look at those forms, and indicate by their serial number which of them it is that may be concerned in the final dividend transaction?

A. All of these in the final dividend transaction; the whole three.

Q. Now will you indicate, if less than all, which of them may be concerned in the paid-up dividend transaction?

A. The full paid dividend grouping would relate only to plaintiff's Exhibit 1-*a*, the limited payment life form.

Q. Have you a type of contract known as the five year option policy?
A. Yes, sir.
Q. Is that one of the types that is involved in the present suit?
A. Yes.
Q. When you find it I will ask you to produce it and have it marked, then I will ask you some questions about it.
A. Here is such a form of endowment plan, five year option.
Q. Be kind enough to explain to his Honor what are the characteristics of this type of policy?
A. Under the five year option contract, your Honor, the five year option policy is a contract whereunder the surplus is left with the Company to accumulate for five year periods, withdrawable only at the end of the first five year period, or it is permitted to remain for a second, and withdrawable as at the option of the insured, from time to time. It is a deferred dividend term.

By the Court:

Q. Is that option required to be exercised by the parties?
A. Ordinarily it was, usually it was, but our practice, after this period had elapsed, that is, the first five years, then it was more or less at the option of the insured, but the original contract was
67 a withdrawal period only; that is, on one of its succeeding anniversaries.

By Mr. Kane:

Q. In other words, the Company waived its right?
A. Waived its right to retain.

By Mr. Pepper:

Q. Did it, in fact, happen that in some cases the right of the insured to withdraw under the terms of the policy accrued to him in the year 1913; that is, the ten months in suit?
A. There were such cases.
Q. And were there instances in which such withdrawals, in fact, took place?
A. Actual withdrawals, aggregating for the ten months $60,000 plus.
Q. And those items took the form of what kind of payments to the insured?
A. In the form of dividends paid in cash.
Q. Cash?
A. Yes.
Q. They were cash payments to the insured?
A. Yes, sir.
Q. Am I right in understanding that this type of contract differs from those that have preceded by the introduction of the time element?
A. Accumulation through a period of years. Not annually.
Q. And the factors represented in the cash payments to the insured are what factors?

A. The same as the abatements, the insured having in each year paid his full premiums, which appear in the tax return gross.

Q. So that in this case, as in the others, the full tax has been antecedently paid to the Government on the full amount of the premiums received from the insured?

A. The gross premiums in each case.

Mr. Kane: Provided there was an act, of course, of Congress levying a tax.

68 Mr. Pepper: I understand it to be a settled principle, where you are construing a tax act, that you have to proceed as if the Act has always been in force. In other words, taxable, as Mr. Kane says, in fact only if there was a tax act on the statute books, but I take it that it would not be a reason for subjecting an item to tax in 1913 which was received in 1907 when there was not an income tax on the ground that what the Government had not seen fit to tax in 1907 it could subsequently tax after the act was passed.

Mr. Kane: That is all argument. That is on the double taxation. I do not think we should interject a matter of argument here. This tax falls in 1913. What might have happened ten years before may or may not have been within the meaning of Congress.

The Court: Still, Mr. Kane, I think we ought to get all the fact situation. If you want to be protected by an objection and an exception, you can have it noted on the record. I will make this sort of an arrangement for you. Either of you may introduce any facts you please, whether relevant or irrelevant, open to objection. I will grant to each one of you leave to raise the question by a motion to strike out, or, put it in this form, that the facts may go in subject to objection, the objection to be passed upon in connection with the final determination of the final questions involved in the case. In other words, we will take it subject to the objection. You can put it in either form you please.

Mr. Kane: I object to it, then, and ask for an exception.

The Court: The testimony is taken subject to the objection, the question of its admissibility held, to be determined together with a determination of any final questions, with leave to either side

69 to raise any question of the admissibility of specific evidence through and by a motion to strike out.

By Mr. Pepper:

Q. I take it, Mr. Garrigues, that when in your answer you spoke of prior premium payments that had been taxed, you were referring actually only to premium payments made in the years when there was a tax law on the statute books?

A. Beginning with 1909.

Q. Mr. Garrigues, because of the introduction of the element of time into the case under consideration, the factor of interest becomes important, does it not, as well as the factor of savings?

A. Yes. The current surplus, annual surplus, from year to year, has accumulated at interest for the benefit of the insured.

Q. And his policy entitles him to take out these accumulations in the way you have described?

A. So stated in the policy.

Q. Will you turn to the next class of cases, which I think are the life rate endowment policies?

A. We have two forms here.

Q. Will you describe to the Court the characteristic features of this type of policy? Go ahead with your life rate endowment policy.

A. The life rate endowment form has been issued for a great many years, and is a combination of ordinary life and endowment insurance. A life premium is paid and the surplus accumulates until such time as the interest accretion plus the reserve value to the sum insured is reached, then it matures as an endowment. That is where the title comes from, that is the significance of the words of the title, "Life rate matured as endowment when surplus plus reserve equals sum insured."

Q. For the sake of the record let me ask you this question. If the policy were merely an ordinary life policy, it would happen, would it not, that nothing would be payable to the insured except in the event of death?

70 A. Correct.

Q. When you introduce an endowment feature you make it conceivable that the insured will get some return from his insurance by outliving the endowment period?

A. Yes.

Q. In that event he will receive something before death?

A. It will mature as an endowment for the sum insured.

By the Court:

Q. Is that anything more than the application of the building association principle to the insurance contract? In other words, as I catch Mr. Garrigues' thought, as he has expressed it, that just as soon as there is an accumulation of funds in the hands of the Company applicable to that particular policy, which equals the amount which they will be called upon to pay in the event of death, then, in the building association language, his policy matures. Isn't that substantially the idea?

A. Yes, your Honor, that is correct.

By Mr. Pepper:

Q. That is not only substantially it, I take it, but, Mr. Garrigues, that is precisely, is it not, entirely what happens?

A. Entirely, yes. That is the exact fact.

Q. And from and after the moment of such maturity, the policy is a paid up policy?

A. The policy is no longer on the books of the Company. The insured withdraws its value.

Q. Did it happen that in 1913 this contingency of maturity actually happened in some cases?

A. Yes, there were such cases, and then there is this perhaps to be said, that there is an option under this contract whereby the insured may intermediately, if he cares to, withdraw the surplus either in settlement of premiums or in cash, in that case, of course,

71 defeating the endowment feature of the contract just to that extent.

Q. Perhaps not defeating it, but delaying it?

A. Either defeating it or delaying it. Perhaps that would be the better word.

Q. Delaying it?

A. Yes.

Q. So that under this type of contract, two special cases may arise; one in which the insured has been self-denying, and has allowed his excessive payments to remain untouched, and the other in which he has drawn upon them?

A. Yes.

Q. To a greater or lesser extent?

A. Yes, there are a few cases of that sort.

Q. But in either case payments made during 1913 were payments out of a fund which had accrued in the way you have described?

A. Yes, sir.

Q. What are the factors entering into payments thus made to the company by the company in 1913? How does it become possible for the company to make these repayments as you have described?

A. They are the redundant premiums which have been accumulating from year to year in which the tax is under review.

Q. Plus the interest factor?

A. Plus the accumulation of the interest in accordance with the contract.

Q. Does it occur to you, then, that there is any material respect in which this typical case differs from the preceding case, so far as the question of taxation is concerned?

A. No, nor the source of the surplus.

Q. Mr. Garrigues, might it be said with respect to this what you said with regard to the other, that during the preceding period when a tax law was on the statute books, that the redundant premiums had in every case been returned and taxed?

A. Being included in the gross premiums, yes, sir. Pre-
72 miums to the full one hundred per cent. in each case.

By Mr. Kane:

Q. And the interest would be how? That would go into your gross income, naturally, would it?

A. Yes, sir.

Q. As interest on the company's investments?

A. General funds. Assets.

Q. General funds, assets?

A. Yes.

Q. In other words, the gross premiums, which you have called gross premiums, the flat premiums, would be reflected as premiums?

A. Yes.

Q. And then the interest part of the accumulation or redundant premiums subsequently repaid was reflected as interest funds. That is your theory?

A. Yes, sir.

By Mr. Pepper:

Q. Was there any form of contract in which these redundant premium payments were available to the insured to hasten or accelerate the arrival of his endowment period?

A. May I interject right here that we have come to a group of cases as to which I have specimens. Do you care to bring this life rate endowment right in here, or finish the question you just asked?

Q. State to the Court what the documents are you have in your hand.

A. I have here a statement of a life rate endowment, policy No. 330,393, which appears on the schedule which has been submitted to the District Attorney on page 39, but here given in detail. The policy was issued in 1906, amount $20,000, at the age of 28. Premium $450.80. The current account, beginning with 1907, is stated. Dividend and interest. Then 1908. The total, the dividend and interest, and so on down. It includes compound interest until surrendered in June 1913, and we also have a duplicate of that card, which is the Company's record for such case.

73 Q. Do the documents which you now produce contain the particulars in regard to some one of the several life rate endowment policies actually appearing in the schedule in this suit?

A. Yes. This is a typical case of this group.

Q. Now, was there any form of contract in which these redundant premium payments were available to the insured to hasten or accelerate the arrival of his endowment period?

A. Yes, the accelerative feature, which we have just described, was also in later years related to an accelerative endowment policy. For instance, a twenty year endowment, by accumulating the surplus, might be made payable and mature in seventeen or eighteen years. We have sample policies here of that form of insurance.

Q. I understand that the question that I asked you introduces the consideration of a new group of policies, because in this group the accumulation to the credit of the insured is available to hasten the arrival of the endowment period. Is that correct?

A. Yes, indicated by the title, "Accelerative Endowment."

Q. In that respect, and in that respect only, it differs from those that have preceded?

A. Similar to the life rate endowment with that single distinction.

Q. State whether or not transactions of that sort came within the period of the tax year 1913?

A. There is a group of such cases. The total surrender, the total fund withdrawn for the ten months period, being a little over $9,000.

Q. And what do you say in regard to the source of those withdrawals?

A. They are the surplus redundant premiums or abatements, as we variously call them, the same as under the annual dividend policy, merely accumulations in accordance with this contract.

Q. And the process of accumulation, as I understand you, involves first the simple addition of successive redundant pre-

74 miums, plus the compounded interest factor?

A. Yes, sir.

Q. Mr. Garrigues, you have several times in your testimony used the term "surplus" without, I think, specifically defining it. I do not mean the Company's surplus, but in its relation to the account of an insured. Will you tell his Honor just what you mean by that term?

A. I have used that term, your Honor, as meaning the redundant premium, anything that has been unnecessary and unused from year to year. An overpayment.

By Mr. Thompson:

Q. Would it include anything else? Would it include any other element?

A. What other element have you in mind, if I may ask?

Q. I am just asking you the question. You were speaking of interest and some other things.

A. When I spoke of "surplus" I had reference to a single year, surplus arising in a given period, within one year, what you might call your current year dividend. That is what I had in mind by "surplus."

By Mr. Pepper:

Q. That lays ground for the next question I want to ask you. What do insurance men mean by the term "accumulated surplus"?

A. That term has been adopted, was adopted by our company years and years ago, to designate a certain form of insurance. It is called variously by other companies "deferred distribution," "deferred dividends," "semi-tontine." There are a great many terms for accumulated surplus under a specific policy.

Q. Is it true that any policy is to an extent an accumulative surplus policy where the insured gets the benefit of the redundant premium payments increased by the compound interest process?

75 A. I should say where there is more than one year involved, yes.

Q. So that the answer to the question that was put by my friend is that you have used the term "surplus" as indicating a one year transaction?

A. Yes, I would say so, concurrently with the dividend or the abatement or the refund.

Q. And when you used the term "accumulated surplus," do you mean to include the interest factor as well as the others?

A. Yes, the exhibit of a withdrawn accelerative endowment falling within the group.

Q. Do you produce the particulars from the Company's records applicable to some one of the accelerative endowment policies that are in controversy?

A. This is a twenty-five year accelerative endowment, policy No. 265,957, issued in 1904, age 32, for $2500, and the accumulations were withdrawn, $112.66, in accordance with the schedule in the month of June, 1913.

Q. Now, Mr. Garrigues, in connection with my question about the

accumulated surplus, you used one or two other terms that become important with reference to the policies that we are now going to discuss.

A. Yes.

Q. The first term, "Deferred dividends," and in the second place the term "Tontine," or "semi-Tontine." Just for the sake of the record, will you define both those terms?

A. What might be said to be the original deferred dividend contract in this country is what is known as the full or free tontine policies; policies whereunder, if the insured lapsed or died, he forfeited everything, his reserve, whatever his surplus might then have contingently been. There was a law enacted forbidding that. They thought it was almost in the nature of a wagering contract, and it was forbidden, and then what was named "Semi-tontine" became the vogue,
76 whereunder the reserve never could be forfeited, the reserve was never subject to forfeiture, but merely the surplus and there was a selected period, whatever it might have been, ten, fifteen or twenty years. This surplus was pooled for the benefit of the persistent survivors.

Q. Meaning thereby those who not only lived through the tontine period, but who persisted in paying premiums?

A. Yes, sir.

Q. During all the time?

A. Yes, sir.

Q. Is that correct?

A. That is correct, sir, yes, sir. Now in this company a policy of that form, this last described form, was named, for the purpose of distinction, "Accumulated surplus."

Q. When you speak of deferred dividend policies, you mean to describe generally all those policies under which the redundant premiums with or without the added interest factor remain for a time in the hands of the company and are accounted for at periods less frequent than a year?

A. Correct.

Q. Will you tell his Honor what the current practice now is among the large and substantial life insurance companies in respect of this matter of deferred as distinguished from annual dividends? Do you write now deferred dividend policies?

A. The laws of a number of states forbid the writing of this group of semi-tontine insurance, beginning in some states in 1907 and others in 1908. It is permissible in a few states still, but most of the companies of standing, particularly those that are writing business in the large commonwealths, must abide by the laws of these particular states, or they cannot do business there. Therefore, the law of New York, for instance, is binding on our own company in that regard.

Q. What is the practice of the Penn Mutual? Do you write these deferred dividend policies now?

A. The company has not issued such a form since 1907.

77 Q. So that in so far as we are discussing in this case deferred dividend policies, we are discussing policies as a type

now outstanding but which as far as now appears are not going to recur?

A. They are obsolescent.

Q. And you use the term "obsolescent" with accuracy, because these outstanding policies are drawing gradually toward their terminal point?

A. They are fading out. They are fewer in number every year as the withdrawals occur, of course.

Q. Have you any type of policy among those involved in this case in which you have a combination of term insurance, ordinary life, and this accumulated surplus type which you have been describing?

A. Would you care to introduce these other policies first? Would you care to introduce the straight cumulative surplus policies first?

Q. Haven't you done that?

A. They have not been produced yet.

Q. Produce those.

A. All right.

Q. You have produced forms of that type, have you?

A. Yes, sir.

Q. Have you picked out from your records the particulars respecting some policies of this type that are in suit?

A. We have here a statement of accumulated surplus policy No. 232,579 issued in 1903 for $1,000 at the age of 39 at the annual premium of $107.20. It shows a statement of the individual dividends of the insured compounded at interest during the period involved, which was ten years, and a settlement effected at the end of that period, which included not only this accumulation, but a share of the forfeitures of the policy holders, who meanwhile in this group had lapsed or died, making the total of $145.91, paid in March 1913 as indicated on the schedule that the District Attorney has, page 27.

78 Q. This is typical of a number of similar transactions occurring during the period covered by the suit?

A. Yes, sir.

Q. Is that correct?

A. Yes, sir, this is one of this general group, and here is also a card indicating the company's method of keeping this record.

Q. Have you any type of policy among those involved in this case in which you have a combination of term insurance, ordinary life, and these accumulated surplus type, which you have been describing?

A. There is such a group known as the guaranteed dividend form.

Q. Is that under the head of the six per cent. bond?

A. Whatever you choose to take up.

Q. Let us take the six per cent. bond first, if that will be agreeable to you.

A. Very well, sir. The six per cent. bond was a contract whereunder there was a stipulation that if the insured should die within the period of the contract, which was twenty-five years, there should be added to the sum insured six per cent. for each year it had been outstanding. For instance, if $1,060 was paid for the first year and

$1120 for the second year, and so on, the premium was calculated by charging the ordinary rate for $1,000, and assuming a premium rate for this increasing amount, starting at $60.00, and running up to the total at twenty-five years, which would have been $1500, and incident to that were the deferred dividends from accumulations, because if the insured survived twenty-five years, the term insurance would have expired, only payable in the case of death. So that in addition to the sum insured, $1,000, at the completion of this endowment period, twenty-five years, he would get also his accumulated surplus, but not, of course, the term insurance, which meantime had served its purpose.

Q. So that, if I correctly understand you, a man holding this type of policy got the benefit of the ordinary life insurance, plus term insurance, if he died within the specified period?

79 A. Yes. That endowment form has been used to the present time.

Q. If he lived beyond the period in question of course he lost the benefit of the term insurance, but in lieu thereof he received his share not only of his own previous redundant premium payments with interest, but all proceeds of lapses due to death or failure to pay premiums in the case of policy holders of his own class?

A. Yes, sir.

The Court: That form of insurance had something of the tontine feature.

Mr. Pepper: Exactly sir. That was a semi-tontine feature in virtue of which a benefit accrued to the man who was fortunate enough to outlive the specified period.

The Witness: Yes.

By Mr. Pepper:

Q. And then the disadvantage of his possible death within that period was guarded against by the feature of term insurance in the interval?

A. Yes, sir.

Q. I suppose it was for that reason, the latter reason, that they introduced the term insurance feature, was it not?

A. Yes, sir, so that in case of what we might call a premature death, the estate would benefit in a certain way. We have here just a summary of such a case, a six per cent. bond policy, No. 51704, issued in 1888, age 30, amount $1,000. Premium $47.65, with the amount of dividends, interest and forfeiture in accordance with the schedules presented.

Mr. Pepper: May it please the Court, I have several times referred and Mr. Garrigues has also referred to a certain schedule. Let me say, sir, that before we close I propose to offer in evidence the documents described as a schedule which in fact contain tabulations from the books of the company of the particulars respecting

80 every policy that gives rise to the question in suit during the ten months' period. These schedules, which are the product

of an enormous amount of labor, were prepared by the officers of the Company; they have been submitted to Mr. Kane and inspected by him and his experts, and they will presently be offered as correct transcripts of the books of the Company, subject, of course, to the right of either party to amplify the proofs or to question the relevancy of any portion of them.

Mr. Kane: Yes.

By Mr. Pepper:

Q. I think you have produced the particulars as to this six per cent. bond case.

A. I have them here, but it is all on the same sheet with two other forms, which I will present to the stenographer in a moment.

Q. With regard to the source of the payments that were made to the insured in 1913, under policies of this type, what have you got to say?

A. They were the redundant premiums of former years with interest accumulations, and the share of forfeitures where a man had concluded a period.

Q. Is it a fact that when we come to semi-tontine policies of the class under discussion, we introduce for the first time the case in which the thing for which the Company asks a credit in its income tax again includes payments to the policy holder of items received from other policy holders, as well as from him himself?

A. Yes, sir, that comes within the semi-tontine, the accumulated surplus group.

Mr. Pepper: Your Honor, of course, catches the point that I am asking Mr. Garrigues about now; as soon as you get into the category of cases in which the payment to the insured includes his share in a fund produced by lapses, you have a case in which the thing returned to him does not originally have its source exclusively in his own pocket, but in the pockets of other persons who
81 have passed out, and it is, among other things, the contention of the Government that there also we fail on the theory that there has to be a return to the man who made the payment, and that we are not entitled to a credit in respect of a return to him of payments which in part originated from the lapses of others who have passed out.

Mr. Kane: I wish to make an objection to the last question and answer.

The Court: The understanding is that we are taking all this testimony subject to the objection. If either of you at any time wishes to raise a specific question on the record, so as to call attention to it at the psychological point of time that you select, make it in the form of a motion to strike out. If you want to raise the question, you can put on the record a motion to strike out, so as to direct the attention of whoever goes over this record to just what your thought is.

Mr. Kane: I will avail myself of the right to move to strike out the witness' answer to the last question.

The Court: I will consider the motion to strike out and dispose of it together with the final question which arises.

Mr. Pepper: So that the effect of it is that the testimony is being taken subject to Mr. Kane's objection?

The Court: That is it.

By Mr. Pepper:

Q. Is the next type of policy the four per cent. investment bond?

A. Yes.

Q. Will you explain that?

A. That was in the form of endowment insurance where the dividends were accumulating during a selected period with a pro-

82 vision that at maturity, if a man was fortunate enough to survive, he had the option of leaving the sum insured with the company at four per cent. interest, on the theory that that was a pretty high rate of interest in those days. The surplus was forfeited to eek- out any deficit, if the man was unfortunate, and died or lapsed within this selected period. As a matter of practice, later, when it was ascertained that he interest was earned at the rate of four per cent., a fair share of this surplus was returned to the surviving and maturing policy holders.

Q. And were payments of this sort made under policies of this type in 1913?

A. There were such. There is a group here in the schedule here mentioned, and I have a specific case, policy No. 236,620, issued in 1903, at the age of 49, for $2500, at an annual premium of $280.15. The record appears on page 36 of the schedule, and the summary is here, $426.73 payment being made in April 1913.

Q. And do you produce not only those particulars but also a form of policy?

A. There is such a policy here—two of them.

Q. And what have you to say respecting the source of the payments made in 1913 to policy holders under policies of this type?

A. There were annual redundant premiums accumulated at interest plus such share of forfeitures as was awarded by the Board.

Q. Am I right in understanding that in the respect covered by my question the source is the same?

A. Yes.

Q. As in the last preceding group of policies?

A. The same source.

Q. Then, was it a final form of guaranteed dividend contract?

A. There was such a contract issued under several forms, and we have two here. Life and endowment.

Q. Are both those forms represented in transactions that took place in the tax period in question?

83 A. Yes.

Q. What kind of a contract is the one under discussion?

A. There was considerable dissatisfaction in the minds of the public with a contract where the surplus was forfeitable in the event of lapse and death, and to meet that situation this policy was devised whereunder there was a guarantee of a certain amount should the insured die before the completion of his period. The Company described this as a guaranteed dividend. It was a certain percentage of the gross premium, twenty-five per cent. or more, and this amount

being carried as term insurance, very similar to the six per cent. bond, under which the annual accretion was $60.00. That is to say, a certain proportion of the annual premium added every year payable in the case of death prior to the completion of the selected period. If the insured survived the period, then he got the same as the semi-tontine or accumulated surplus policies.

By Mr. Kane:

Q. But his dividends were guaranteed up to a certain limit?

A. In the sense that he bought term insurance it was the equivalent of a dividend and at an agreed rate. If he bought it and he wanted a guarantee of twenty-five per cent., we would give it to him at a certain premium, and if at a little higher rate, then at another rate of premium.

By Mr. Pepper:

Q. We are not to understand, however, Mr. Garrigues, that the Company made any guarantee in these cases of payment to the insured otherwise than as the result of his own premium payments?

A. No, only in case of death. The annual surplus and accumulation at the end of the period was upon the same basis as any other policy issued of the same kind and at the same age and in the same year.

84 Q. And the term "guarantee" used in that connection was to give the insured the satisfaction or certainty that he was going to get something even if he died within the period?

A. In case he died.

Q. But whatever he got was paid for by his own premium, was it not?

A. Undoubtedly, yes, sir.

Q. What is the fact in regard to the settlements in 1913? Were some settlements made in this type of cases?

A. Yes. I think perhaps that we ought to say that in this schedule there is no amount claimed indicated by the word "guaranteed" that we have been discussing, not term insurance, because that would naturally fall in the payment of death losses. The accumulations were merely annual payments (abatements) of premiums accumulating at interest plus a share of the forfeitures in each case. There is a total here of ten months of something over $39,000, and we have a summary of such a case. Policy No. 89,170, issued in 1893, at age 29, for $2500, at an annual premium of $78.15, with the amount of dividends shown, interest, share of foreitures, and the payment was made within the year 1913. That concludes the cases.

Q. And what have you to say in regard to the source of the payments made to the insured in the way you have described?

A. The source was the redundant premiums paid by the insured or of the co-partners in the group.

Q. There was here the element of semi-tontine insurance as in some of the other cases that have been discussed?

A. Yes, sir.

Q. How far does es that exhaust the types of policies with which we are concerned?

A. We only have ave one other group, and it does not fall, perhaps, within this category ory, because it is merely an interest payment.

Q. You m might state it so that we get it on the record.

85 A. It is c s called here in this summary, "Trust certificates." When a poli policy holder who has an instalment policy dies, it has been the practic tice of the Company for a series of years to allow interest to accumulate ate on the fund remaining with the Company from year to year. For or instance, a trust certificate policy payable in twenty instalments ts of $1,000 would net the estate $50.00 a year. That would be the e present value of the remaining $950 in our hands for a year, and so o on successively down as the payments were made. The Board, realizin zing that that fund was invested among the Company's assets, thou ought that the beneficiaries should have their fair share of such inter terest, and it was awarded to them, and that falls then within this gr group, which for the ten months amounts to something over $15,000. 00.

Q. This case that hat you are now describing is the first one in which the redundant pre remium payment fails to enter into the payment made to the insured red. Is it not so?

A. There are no no premiums involved in this case. This loss has been paid as a deat ath claim.

Q. This is purel rely a case of distribution of interest earnings?

A. Yes.

Q. To the insure ured?

A. Yes.

Q. And if the co contention of the plaintiff can be sustained in respect to this class o s of cases, it is on the ground that the Company is entitled to deduct p t payments made under policy contracts. Is it not so?

A. Yes. That is is the point.

By Mr. Kan Kane:

Q. It is a pure c e question, as you view it, of dividing the interest with or amongst th the policy holders remaining?

A. Payable in ac accordance with the contract.

By Mr. Pepp Pepper:

Q. Let me ask w whether some transactions of that type appeared in 1913?

86 A. Yes, s. As I have explained, there is a total for the ten months in th p that group of something over $15,000.

Q. Are there an any cases of policies under which payments were made or credits gi given to policy holders in 1913 that do not fall within some one of of the typical groups that you have described?

A. No. This ta tabulation covers the entire amount of payments crediting them as d dividends paid in cash.

Mr. Pepper: In n order to have on the record, Mr. Kane, a convenient summary, y, would it be convenient to you if I were to offer

in evidence the summary that Mr. Garrigues has in his hand, which is, as it were, sort of an index to his testimony?

Mr. Kane: Certainly not, with an objection raised as to relevancy.

Mr. Pepper: I will qualify the offer. Mr. Kane. I offer in evidence as a plaintiff's exhibit the summary prepared by Mr. Garrigues and produced by him as being in effect an index to the testimony which he has given, and subject to all proper objections to which the testimony itself is subject.

By Mr. Pepper:

Q. Then, Mr. Garrigues, will you produce the documents which have been collectively referred to as the schedule?

A. The District Attorney has those papers.

Mr. Kane: The papers will be brought in.

Mr. Pepper: You need not get them now.

By Mr. Pepper:

Q. Will you produce, Mr. Garrigues, the documents which have been referred to as the schedule, together with the summary in such schedule, in order that they may be offered in evidence?

A. They are in the hands of the District Attorney at the present time.

Mr. Kane: We will produce them.

87 The Witness: They are in the hands of the District Attorney. They will be produced.

At 1.15 p. m. a recess was taken until 2.15 p. m.

2.15 p. m.

Present: Parties as before noted.

FREDERICK H. GARRIGUES, recalled.

By Mr. Pepper:

Q. At adjournment I was asking you about the production of the documents that we have described as schedules.

A. Yes.

Q. Are you in a position to produce those now?

A. Yes, sir.

Q. You do produce the schedules in response to my request?

A. Yes, sir.

Q. Will you be good enough in the first place to hand them to the stenographer to be marked and then tell the court just what they are.

A. The larger schedule, your Honor, which the stenographer will later number, covers the dividends allowed in cash under policy contracts aggregating for the ten months $683,729.03.

Q. Of course, you refer to the ten months covered by the statement of claim in this case, namely, the last ten months of 1913?

A. Correct, sir, and as set forth in the summary which has already been submitted. There is another schedule here which will have its appropriate number, which sums up the dividends that were left with the Company for accumulation at interest and withdrawn during the year 1913. In making the return to the Government we proceeded on the theory that the Company should receive credit only for actual disbursements. In making our return to the State Insurance Department, and in conformity with their blank, they require us to enter in the appropriate place under "dividends,"
88 our paid in cash, and so on, an item called "dividends left with the Company at interest," which is not an actual disbursement, so that we have not taken credit for that sum, which, in my opinion, for instance, might be $26,000, but have asked for credit for so much of that fund which accumulated in the prior year as was actually withdrawn during this tax year of 1913, and in this case for ten months it totals $2,774.35, and the sum of those two is the amount of the Company's original claim of $686,503.38.

Q. When you speak of the original claim you are specifying the principal sum on which you claim an exemption?

A. Precisely. This is the principal taxable at one per cent. The reason I said "original claim" is there were certain small items later conceded.

By Mr. Kane:

Q. The original claim was what? I mean the amount, the figures?

A. $686,503.38 at one per cent.

Q. Now it is $683,729.03?

A. That, sir, is the total of this large schedule. This additional $2,774.35 is what is embraced within the smaller schedule, making the total as I have stated.

By Mr. Pepper:

Q. In other words, Mr. Garrigues, is it correct to state it this way, that the amount claimed in the statement of claim as the sum to be recovered from the Government is the tax on a grand total which is made up of the sum of the two schedules that you produce?

A. That is a correct statement, sir.

Q. And the total embraced in the larger schedule being how much?

A. $683,729.03.

Q. And the amount embraced in the smaller schedule being how much?

A. $2,774.35.

Q. And the total of those two being?

A. $686,503.38.

89 Q. And the amount claimed in this suit is one per cent of the latter figure?

A. Less certain slight amounts which have been conceded.

Q. You have explained that on your books and for the purpose of certain returns to the State Insurance Department, you take a credit in respect of sums payable to policy holders in advance of the date when those are actually drawn down by the policy holders in cash or in other values. Is that correct?

A. This peculiar situation develops that in accordance with the requirements of the State Department, we put in their blank as disbursed some money which is not disbursed, then later on it is disbursed, so we have ignored the first, simply taking credit for the payments as made.

Q. So that it is correct to say, is it, that in these schedules as now presented the items of credit appear as of the date when they actually were passed to the insured either in cash or in other value?

A. Within the year of the tax, 1913, in this case.

Q. 1913 in this case?

A. Yes, sir.

Q. What is the source from which these schedules have been made up?

A. From the records of the Company.

Q. And does anything appear in them excepting matter found in the books and records of the Company?

A. No, and they are in exact accordance with the return as filed with the State Department and with the Government.

Q. And are the schedules self-explanatory? In other words, are the figures grouped under headings which need no explanation?

A. They are grouped in accordance with various classifications of the policies as explained this morning.

Q. And state to the Court whether or not these two schedules between them include the essential particulars in regard to every policy that was affected by transactions occurring in 1913 and covered by this suit.

90 A. Yes, every case where a cash dividend was paid within 1913.

Mr. Pepper: May it please the Court, as I explained this morning, these schedules have been made up from the books of the company, have been submitted to the District Attorney, and I offer them in evidence, subject to the right of either party to supplement them by other evidence from the books, or from other sources, and subject also to all proper objection respecting the relevancy of any item contained in them. In other words, I offer them with the consent of the District Attorney as being the equivalent of what the corresponding entries in the books would show if they were produced.

Mr. Kane: Precisely so. We filed a stipulation to that effect, sir. It is on the record.

Cross-examined.

By Mr. Kane:

Q. Mr. Garrigues, you have said that from time to time these dividends were declared and passed to the individual policy holders.

Will you enlighten us as to just what entries were made in the process of passing them to each particular policy holder? I mean in a general way. Of course, there would be a different entry in each class of cases, but, first of all, are the entries made in books, or are the entries made on cards?

A. Formerly in books, and perhaps some still in books, but in the main, in the evolution of business, card records are kept mostly.

Q. Were card records kept in every case? You have given us a few cases, sample cases, showing what was done in the case of particular policies in 1913. I ask whether card records or book records substantially the same were kept in every case?

A. A record is kept with each policy holder.

Q. And to the extent, then, as shown by these particular
91 cards, there was a passing to the individual policy holder of a particular dividend?

A. Yes, and the sum total carried in the company's liability, so that it was undoubtedly credited to this insured member.

Q. Was it credited in any other way than upon the cards?

A. Of course, there was the method of calculation, which was a subject of record elsewhere. For instance, in the determination of the distribution after the sum is awarded by the Board, a schedule is prepared, which would undoubtedly indicate it. The share of each member depends on the year of issue, the age at issue, the kind of insurance, and the amount. Now, we have a record, then, prepared from that schedule, which indicates that a man, say, insuring in 1912, at the age of 21, on the ordinary life plan, is entitled to so much dividend per one thousand, and if he has one, that is passed to his credit, or in another case ten, that goes on the same card, multiplied ten times.

Q. I see. That entry on the card in each case is the result of the resolution passed?

A. Yes, and of the distribution as described.

Q. But it is the only actual evidence upon your books or records of any kind of that distribution?

A. No——

Q. In other words, I understand there is a calculation made for each individual policy holder, and that calculation is,—a record of it in a particular case is entered on the card?

A. Yes.

Q. And that is the act that you speak of when you say that a dividend of so much would be allotted to a particular policy holder?

A. For instance, does your inquiry tend to this point, as to whether there is a duplication of records in our office, or is that material to your query?

Q. Yes, it might be. Is there a duplication, or not?

A. There comes about a duplication. That was what I was
92 trying to bring before you. There comes about a duplication in that all premiums collected by the Company's general agents, and remitted from the agencies established throughout the country—there is a monthly report of accounting, and upon that will be entered the man's number, the name, the premium, the

award of surplus, the net premium, and an audit on that assumption. I think that would be a duplication of our individual record.

Q. But it is the same thing. It is a duplication of the record.

A. Of the precise amount in dollars and cents in each case. There is no lumping at all.

Q. Of course, it is a fact that the premiums as they are paid go into the general funds of the company, and are invested in bulk, of course, as we understand it.

A. Yes, sir.

Q. And the company is able to get varying amounts of interest, or varying rates of interest dependent upon the conditions of the times and the rates of interest?

A. Yes.

Q. And then as each year's business comes to an end, an estimate is made, and a division made, and the thing, the dividend, in other words, etymologically speaking, due each policy holder is put on his card?

A. Eventually.

Q. It finds its way through?

A. Eventually. I might say, amplifying my former statement, that the dividend record in a given case is put on the individual card representing the policy holder's ledger account when he pays his premium, not before. That may happen any day throughout the year.

Q. In the case of deferred premiums that run over a number of years before there is any settlement with the policy holders, then there is no record meantime made of his individual share?

A. On the contrary, there is a specific record made with each policy holder, whether his dividend is used annually, or deferred.

Q. But that record is limited to this entry on the card, and
93 possibly duplicated in the case of the branch offices of the Company?

A. Yes, but there is the individual accounting with everybody.

Q. With everybody?

A. Yes, sir.

Q. And that is his share in this undivided redundant dividend?

A. His contingent share.

Q. His contingent share?

A. Yes.

Q. So that, after all, it is a contingent credit, is it not?

A. His deferred dividend. Accumulated surplus, as we call it.

Q. It is contingent upon two facts, is it not, the man living, and the man paying?

A. Those two.

Q. Strictly speaking, it is not a credit, is it, as we ordinarily understand "credit"?

A. It is placed there in his individual account. We know what it is, and it is going to be his some day if he persists and lives.

Q. You might call it an account of contingent credit?

A. Perhaps.

Q. That may be his share subject to these contingencies in this

salvage fund, and that salvage fund, as a matter of fact, is kept invested, is it not?

A. Yes.

Q. Where there is a deferred dividend I understand the interest is compounded from year to year?

A. Yes.

Q. That means exactly what?

A. It means that the dividend bears simple interest the first year. That total is carried forward, the next year's dividend added to it, then interest upon the total, and so on, as the statements which have been submitted show.

94 Q. Of course, in the actual investment of moneys of the company there is no such compounding, is there?

A. Please repeat that.

Q. In the actual investment of the moneys by the company there is no such compounding, is there? You have long time bonds, have you not?

A. In a sense there is, because our reserves are based on the theory that they are earning so much interest compounded from year to year, and they go forward at that rate.

Q. Yes, but you could not say that there was any compounding of interest really by the Company; the Company does not, as a matter of fact, put interest and principal at the end of one year into a fund, and then charge interest for the next year upon principal and interest?

A. The fact is that any unused portion of the year's income is reinvested and a good portion of that would be perhaps interest.

Q. Any unused portion?

A. Any unused portion of the year's income would be invested again.

Q. But the great mass of moneys at interest held by the Company are held not merely for one year, but for periods, until the bonds are paid, I suppose—bonds and mortgages?

A. True, but if the income from that bond or from any bond, were not required in the conduct of the business, then the yield would be reinvested from year to year?

Q. Yes, that is true, but never is added to the reserve fund, you say, to guarantee to the policy holder a compound interest, interest compounded on his dividend, where the dividends are deferred?

A. At the end of each year there is a sufficient sum added to the outstanding reserves which, with the interest which they themselves will earn during a succeeding year, will be adequate to meet all the policy claims of the company.

95 Q. Taking up the summary of dividends, interest, forfeitures and premiums, in other words, the summary of our big schedule, will you tell me whether there is any interest included in the sums in the first column headed "Individual dividends"?

A. There are no interest accretions in that column. As was described this morning, there are three elements that are component parts of a dividend.

Q. I am now speaking of the paper headed "summary of dividends, interest, forfeitures and premiums."
A. Yes.

By Mr. Thompson:

Q. Are these figures in this divided column dividends from deferred redundant premiums, or are these annual premiums?
A. In this first column headed "individual dividends," there is the sum total in a given case over the period of exposure, which, we will say, is twenty years, which is identical with another policy holder of the same age and kind, who has the same kind of insurance, who had taken his dividends annually and in abatement. They would be totalled absolutely the same. That is the reason we put the heading to the column "Individual dividends," showing that it was the individual share from the successive years, just the same as though he had withdrawn such an amount annually.
Q. What I wanted to get clear was this. I understood you to say that in the annual dividend there was the element of simple interest, and in the deferred dividend there was the element of compound interest, and that this summary here was a showing as to deferred dividends. Now, you have also stated, just how, that this first column made the same showing as though it were an annual dividend?
A. Yes.
Q. That is what I wanted to get clear, whether this first column has in it in addition to the actual amount, the excess amount received from the insured; whether it has in it also the element of simple interest?
A. It has no interest other than the interest factor which goes to make up every dividend.

96 By Mr. Pepper:

Q. That is the saving of interest?
A. The saving of interest as set forth in this typical case this morning as ten dollars, and that ten dollars of annual dividend to the policy holder is reflected as ten dollars in this column. No more, no less.

By Mr. Kane:

Q. In other words, the figures in the first column are made up exclusively of the three things, assumed mortality, interest assumption and expense loading?
A. Yes, sir.
Q. Technically called loading, expense loading?
A. Yes, sir.

By Mr. Thompson:

Q. All of which would be received as part of the premium?
A. It would be a part of the premium, and would be abated annually if the man took it so.

Mr. Pepper: Mr. Kane, will it disturb you if I suggest one slight correction?

Mr. Kane: No.

By Mr. Pepper:

Q. Mr. Garrigues, your statement was that the first column contained the assumption of those three points. That is not correct, is it?

A. Excess or salvage.

Q. It is the correction of the original assumption that it contains?

A. Yes, overpayments.

Mr. Kane: Exactly.

By Mr. Kane:

Q. In other words, it is the differences between the contract—your claim is, of course, and I suppose we do not dispute that at all, it is the sum total—these particular figures in any one case is the sum total of the differences between the contract and the actual—

97 A. What is required to carry the risk during the year.

Q. Actually having proved less than the contract figure?

A. Yes.

Q. To that extent there is under what we have called, if you choose, the correction for interest assumptions,—whatever was necessary there to make the policy self-sustaining, so to speak, with regard to interest which the Company might not earn, to that extent it is an element equivalent to interest there, but it is not interest on any moneys that the policy holder put forward; interest except to that extent?

A. That is correct, sir; it is not interest "on" but interest "in."

Q. On the other hand, when we come to these cases of—the first "A. S."—accelerated surplus, is it not?

A. Yes.

Q. "Guaranteed dividends," "Four and a half," and so forth, or interest bonds, where there are figures in the column headed "interest," then we come to a proposition of where there is a compounding of interest allowed by the Company on dividends not withdrawn?

A. Correct. That is the column headed "Interest." That is such interest as you have described.

Q. And that is an imaginary interest, really, an interest allowed, but an interest of course which, strictly speaking, was not earned by any investment. It is paid by the Penn Mutual Company, it would be paid over eventually, but it does not represent any actual interest received by the Penn Mutual Company upon any moneys invested?

A. On the contrary it is received. The Company funds are invested, and the interest which is allowed in those dividends has been earned on the sums which are a part and parcel of the Company's invested assets.

Q. To make the distinction which I want to make clear, and to see whether my thoughts are clear, let us take the case of the $100,

which would be a flat premium, and let us assume it has run
98 on five years, when each time the actual cost of insurance was less by ten dollars, and let us assume that the policy holder has not until the fifth year withdrawn. That would be a case, perhaps, in one of these groups. Might it not be?

A. Yes.

Q. The policy holder withdraws then the fifty dollars finally, we will say, or it is then used by him, five years running, $50.00. Now, in the case of the deferred premium, take four years, and he had not withdrawn any ten dollars at all, and on those separate sums of ten dollars that accrued, came into existence, and which were entered on his card, during the four previous years, where there had been no withdrawal at all under the terms of the policy. I suppose that was added, as I understand it, in an interest sum?

A. Yes.

Q. And that would be reflected in the interest column?

A. Yes.

Q. You are right about that?

A. Column No. 2, or Column No. 3, here.

Q. In other words, at the end of five years we will say there would really be a deposit to his credit of his previous premiums with ten dollars additional, which was his dividend of that year, and then interest is figured on the premiums of the five years plus the ten dollars, then on the next year it would be interest on that plus the ten dollars of that year, and so on?

A. Upon those dividends which accumulated and had not been withdrawn.

Q. And the interest so far as those two or three years are concerned, which finally comes to him, is figured on the particular redundancies in his premiums, or redundant premiums?

A. From year to year.

Q. From year to year?

A. Yes, sir.

Q. With particular differences in his case?

99 A. Yes.

Q. At the same time I understand there was to meet that claim,—of course there was finally to meet it the investments of the Company?

A. Yes.

Q. Which were earning interest, and you say there was also a reserve fund specially put aside?

A. A liability item. That is distinguished between "Reserve" and "Accumulated su-plus," because "Reserve" is a technical name meaning the amount to mature the policies, and this is something a little different.

Q. In theory you would say, and perhaps in fact the stock holders' money, I mean the policy holders' money, was actually earning those sums of interest?

A. The company can have nothing that does not begin in a premium. Everything else is the outgrowth of that.

Q. The outgrowth of investments made?

A. The outgrowth of premiums. The investment of the premiums themselves.

Q. The premiums are invested, of course?

A. Yes.

Q. And they yield a certain interest?

A. Yes.

Q. Then there is put aside something—what did you call that? Reserve?

A. Reserve for the maturing of the policy contract first, that is the largest item of all, and then there is this accumulated surplus.

Q. Accumulated surplus?

A. Yes, in a separate fund.

Q. Which is also a separate fund, and that is to meet these interest charges in the case of the deferred dividends?

A. Yes, to meet the entire payments from year to year.

Q. Of course, there are two distinct things, are there not? There is the interest accumulating on the investments of the Company, and the money also in this accumulated surplus reserve?

100

A. Yes.

Q. Those are moneys loaned by the Company to individuals or corporations, and bringing in interest all the time to the Company.

A. Such a distinction as you draw is not actual in fact, because while we have an item of many millions, say twelve millions of accumulated surplus, there is no segregation of the assets to represent that twelve millions. There is a book entry and credits to policy holders, but it is lumped in the investments of the Company generally.

Q. Exactly. Of course there is, therefore, as we know, no preservation of the policy holders' money as such? It becomes the money of the Penn Mutual Company and is invested by it?

A. To which the individual policy holder has, of course, his continuing right, in accordance with his contract.

Q. His continuing right, which we lawyers would designate, really, as debtor and creditor. A contingent claim, in other words. But, of course, that would be a matter of argument, but there is no question about that as a fact, that the moneys of the Company are invested and entirely apart from these continuing accounts with the policy holders?

Mr. Pepper: I do not want to interrupt, but I do not want to seem to acquiesce in the statement that the relation of the policy holder and the company in the case of these mutual insurance concerns is of a pure debtor and creditor. I think you rather were getting Mr. Garrigues to assent to that as a conclusion of law.

Mr. Kane: I am wrong about that. I understand perfectly well this would be a question of law. If I misstated the law, it has been my misstatement, and not Mr. Garrigues'. I wanted to get the distinction perfectly clear, Mr. Pepper, between the interest which, as I understand it, is figured in the shape of dividends and the interest which is acually paid upon the invested funds of the Company. I think we have made that clear.

101

By Mr. Kane:

Q. In other words, the latter, the interest paid to the Company on its investments, is used to pay the interest to the policy holder,—to pay the dividends to the policy holder?

A. To pay the interest or dividends to policy holders in accordance with their contracts.

Q. To pay the interest.

A. If I may amplify that a little, we like to look upon a company such as ours as an aggregate of members, just as though this room were full of members of the company, and there is no debtor and creditor in the sense of an ordinary commercial transaction, but that each policy holder has a share of the whole, gets his contribution in accordance with what he in fact did pay to the company.

Q. That is a legal question. Now with regard to the shares of forfeiture. I think there are four different classes of policy holders in which there is this semitontine feature?

A. Yes, four.

Q. Four?

A. Yes.

Q. In the summary you have described it as "Shares of forfeitures"?

A. Yes, sir.

Q. You have described these particular sums?

A. Yes, sir.

Q. And in each particular case it is the share of the particular policy holder in the lapsed surplus, do you call it, or in the lapsed surplus due to other policy holders either having died or failed to pay up. Isn't that it?

A. The surplus that intermediately had been credited to those who failed to pay premiums or who died is forfeited to the
102 pool for the benefit of the survivors who persist.

Q. And that money, of course, with its accumulations of interest, came from other policy holders, did it not?

A. Yes, from premiums of other policy holders who had fallen by the wayside.

Q. It, therefore, of course, is in no sense, or, speaking more accurately, the portions of that fund which represent the shares of individual policy holders in our schedule here, in no sense were ever paid by them to the Penn Mutual Company?

A. By the recipients, you mean?

Q. Yes.

A. No, but they were paid by other policy holders whose premiums were taxable gross.

Q. But it could only be on the theory of a gross premium that the amounts now paid to the individual policy holders remaining were paid back as part of premiums? It could only be on the theory of gross premiums, of course?

A. Yes, and taxable gross premiums, and those are merely redundant portions, plus their interest accumulations.

Q. In other words, we there treat the policy holders of the company as one, as having one head, if we are to regard these shares of forfeitures as portions of premiums paid the company?

A. Paid by some member of the Company, yes.
Q. Paid by some member of the Company?
A. Yes.
Q. In other words, we have got away entirely from the individual listing theory, and, to use the economical expression, we are now speaking in a collectivist way.
A. This schedule and this summary, if I might state, was prepared in this way because of certain rulings of the Department, and in order that the Court might be fully informed on any question that might arise.

Q. I understand, but it would nevertheless be true of any
103 case of the four first groups in order mentioned in the summary but not in the order mentioned, of course, as we took them up this morning, that the totals which the Company seeks to exclude, or which the Company contends they have the right to exclude in 1913 from its gross income, do include shares of forfeitures of premiums not paid by these particular policy holders, but by others.
A. By other people whose premiums were taxed upon the gross sums.
Q. This morning we spoke from time to time of, I think the phrase was used of portions of a premium in effect returned to the policy holder. That never comes about excepting in payment of a cash dividend, does it? He gets something else for that dividend? It remains with the Company, or he gets something else in the case of the abatement, but only where there is an actual cash payment of the dividend to the policy holder is there ever a physical return to him?
A. Yes. That is all that is included in this statement.
Q. But in this statement we have nothing but cash.
A. Cash transactions.
Q. Cash transactions?
A. Yes.
Q. In this statement we have nothing but cash transactions entirely?
A. Perhaps I ought to qualify that in a slight degree, because if the insured has an outstanding lien, for instance has borrowed money with which to settle premiums and has an outstanding lien of $100, and we owe him $200, it is customary for the companies to let him have his $100 note, the lien, and $100 in cash, but in that sense it is a cash transaction, because it is the wiping out of an obligation.

By Mr. Thompson:

Q. Barring these incidental cases, it is all a cash transaction?
A. Yes, sir. He was paid the cash in the liquidation of the loan, and I make that distinction.

104 By Mr. Kane:

Q. Here is a matter I do not think Mr. Pepper touched upon, but I wish you would explain it. After the column headed "total" in

the summary comes a column headed "last premium." What is meant by that? You might explain what is meant by "last premium," and then the next column "Received prior to 1913" and the next column, "Received 1914." What does "last premium" mean?

A. A policy is occasionally reduced in amount, and if we said "annual premium," it might be the first annual premium, or it might be the last, or it might be some intermediate premium. The policy might be reduced two or three times. We have had such cases where the insured member took a policy for $10,000 and he found it difficult to continue so much and he reduced it to $7,500, later to $5,000, and later maybe to $2,500, but we have indicated here the premium which was paid the last year the insured was a member of the company on this particular policy embraced within this schedule. It means an annual premium covering the last year of the member carrying this insurance. Of course, he might have several policies, only dropping one. That is the reason I qualify that statement. That "last premium" means the last annual premium on the policy surrendered for cash.

By Mr. Thompson:

Q. On the policy surrendered?

A. On the policy that he surrendered for cash. Here it is on this schedule. Is that perfectly clear?

By Mr. Kane:

Q. Yes. I do not know whether we do understand the last column. Won't you take all those three last columns and explain why you have separated the figures into "Last premium," and then "Received prior to 1913" and then "Received 1913," because, as I should understand it, the last premium was received in 1913.

105 A. No. On the contrary, most of the last premiums in these cases were received prior to 1913. The settlement with the insured was in the main one year after the payment of his last premium. Let us take a very simple case, divorcing this for the moment. A twenty year endowment. The insured pays that twentieth premium, not at the twentieth year, but beginning at the nineteenth year and one day, the policy matures at the end of the last year. Then, the settlement comes in the twenty-first year. So he paid no premium in the twenty-first year, although he gets a dividend. He paid that last premium at the beginning of the twentieth year. He gets a settlement at the beginning of the 21st year. We call it at the conclusion of the twentieth year, but it is really either the very last day of the twentieth year, or the day after. So that the dividends in the main, or the abatements, or whatever they may be called technically, arise out of the premiums theretofore paid.

By Mr. Thompson:

Q. "Received 1913." What does that mean?
A. That is, this very last column?
Q. Yes.
A. These are for cases where a policy may be payable quarterly or half-yearly, or cases as an ordinary life policy where a man settles his accumulated surplus period in twenty years and withdraws merely the surplus but continues to renew the policy by the payment of another premium; in other words, in his case, he made twenty-one premiums, you will see, and his dividend would be paid in that twenty-first year, because he has a continuing contract. Most of these are either limited payment life, or endowment policies, at least a great many of them are. Even those which are on the ordinary life plan are in the main cashed in at the end of a selected period. Some, however, are continued longer. Then we have a premium in the twenty-first year, you will see, or the sixteenth, or the seventeenth, or whatever the period selected may be.

103 By Mr. Kane:

Q. So that there will be many policies on which nothing was received by the Company whatever in 1913?
A. Precisely. If you will sum across one line, 1913, amount received prior to 1913 and received in 1913, you will find that that tabs up with the total in the column headed "Last premium." We have divided those, made them in two columns, indicating which was paid in the taxable year, and which was before.

By Mr. Thompson.

Q. But part of the last premium was paid in the taxable year?
A. Yes, sir.

By Mr. Kane:

Q. And by going to the schedule itself we can tell exactly what particular policies?
A. There is a line representing each individual policy, the number given, and then the various items respecting each.

By Mr. Thompson:

Q. Mr. Garrigues, I understand that the amount in controversy the amount involved, is from dividends wholly?
A. Dividends and from interest accumulations as set forth here.
Q. I understand that the contention of the plaintiff is that dividends in your definition of dividends includes that. Am I correct?
A. We claim that the Company is entitled to deduct the interest paid upon dividends as a payment under a policy and in accordance with it.
Q. The claim of the plaintiff here involves, then, the three items

of what you have listed here as dividends, interest and forfeitures?

A. Yes.

Q. And you refer to only one of those as dividends?

107 A. No, they have been entered in our statement throughout the reports to the Insurance Department and otherwise as dividends paid.

Q. The whole thing?

A. Yes.

Q. Then, in that sense the amount in controversy is what in the definition of the Company is referred to as dividends?

A. Cash dividends, yes.

Q. You have stated that you make a determination at the end of the year as to the amount of any particular premium which is in excess of cost. At the end of what year is that determination made?

A. At the end of each year there is an account stated.

Q. The calendar year?

A. At the end of each calendar year. We have no fiscal year other than a calendar year. At the end of each calendar year there is an account stated showing the redundant portion of premiums, the unused portion, after the year's expenses and obligations are all settled, and then there is a distribution of that amount in accordance with a formula prepared by the actuary, which gives to each member a proportion of his contribution. Now, we do have a dividend year other than a calendar year, because for practical business reasons it is impossible to begin the distribution of surplus on the first of January in accordance with a determination of the 31st of December. So that we have a dividend year which begins on the 1st of May.

Q. But your actuarial determination is made as of the fiscal year?

A. As of December 31st in each case.

Q. And if the calendar year is your fiscal year, of course your return is made on or before March 1?

A. Yes.

Q. After the end of the taxable year?

A. Yes, sir.

108 By Mr. Pepper:

Q. Some questions were asked you respecting the allowances of interest to individual policyholders. Will you make it a little more clear just what the source is from which interest is paid to a policy holder whose excess premium payment is left with the company to accumulate.

A. Such surplus is in the general assets of the company, invested as such, and the policy holder, being the member of a mutual organization, gets his share.

Q. You speak of "his share." Are we to understand that the formula for calculating his share segregates an aliquot part of interest earnings to him just as it does an aliquot part of anything else in which he participates?

A. In the sense—perhaps I will have to elaborate that a little.

Q. Yes.

A. The contracts of the Company with members specify for varying rates of interest, and in order to make perfect mutuality as among them, there is each year an award by the Board of an excess interest to bring it up to as nearly as may be the net interest earning of the Company, and that has been set for several years at four and a half per cent., and that is about as nearly as may be the Company's actual earning.

Q. Does it ever happen that in order to satisfy the requirement of A's contract, you have to aliquot to him moneys which are subtracted from B's share?

A. Not at all. A's surplus left with the Company is in the Company's assets and earns its own interest.

Q. So that under no conditions can A receive more than A's pro-rata of the entire fund?

A. Unless the Company should by accident award more than the net interest earnings in a given year. Practically, of course, it never happens.

109 Q. I mean eliminating mistakes and eliminating intentional wrong-doing on the part of officers. The theory of distribution is a contribution theory, is it not?

A. Precisely.

Q. Which allots to each man his share and no more than his share of a common fund?

A. Exactly. His own proportion, and no more.

Q. And that applies to so much of the fund as results from interest accretions, as to the portion of it resulting from any other source?

A. Yes, sir.

Mr. Pepper: We have in Court other officers of the Company in case it was desired to substantiate any of the definitions or facts to which Mr. Garrigues has testified.

The Court: If they are not controverted I do not see why Mr. Garrigues' statement is not sufficient.

Mr. Pepper: I was going to suggest that to Mr. Kane.

Mr. Kane: That is our feeling entirely.

Mr. Pepper It would simply be explaining how these things are done. I think it would be just a waste of time.

Mr. Kane I think Mr. Garrigues was so clear, and Mr. Pepper's presentation of it was so clear, that we understand it.

Mr. Pepper: Then, may it please the Court, the Plaintiff rests.

Mr. Kane: Mr. Pepper, would it help at all to put in evidence this annual return of the Company? That shows a little clearer to his Honor just how the thing happened.

Mr. Pepper: We have no objection to that at all, sir, no, sir. May it please the Court, it has been suggested that it may make the record more complete if the Company's original return to the Gov-

110 ernment is introduced, and with your permission, sir, we will ask Mr. Garrigues to produce it, and we will offer it. I had not thought about it, but the District Attorney has suggested that it be done.

By Mr. Pepper:

Q. Mr. Garrigues, the Company, I understand, made the return as required by law to the Department at Washington?

A. For the year 1913, yes.

Q. Have you in your hand the original return which was thus made?

A. I have the return as of December 31, 1913.

Mr. Pepper: I offer in evidence the original return, which will be duly marked.

By Mr. Pepper:

Q. I will ask you, Mr. Garrigues, to make any explanation necessary to tie up the figures upon it to those which have been covered by your testimony in relation to the issues in this case.

A. In arriving at the gross income there was, under a request of the Department an explanatory statement made, the first item of which is total income, in accordance with the books of the company, and as required by the State Insurance Department. Then there are several items of various kinds of dividends, the first of which is the dividend paid in cash, $817,607.81, and the last of which is the dividend on deposit, surrendered during the year, $3,166.08, and the total of those two items is the matter that has been considered today in so far as the ten months at issue are concerned, not exactly ten-twelfths of those, but actually ten months from March 1 to December 31.

Q. Am I right in understanding that the return as filed is for the entire calendar year of 1913?

A. Yes, sir.

Q. So that in order to segregate the figures for the ten months, beginning with March 1, 1913, it is necessary to pick out from the statistics entering into the return those which actually
111 concern the ten months' period in question?

A. Yes. Such segregation has been made in the two schedules submitted.

Mr. Kane: As this return is an original record, perhaps it ought to go to Washington, and photographic copies of it may be made in lieu of it. I will have photographic copies made of it.

Plaintiff rests.

Mr. Kane: We have no testimony to offer, under the facts, it being a question of law. Mr. Thompson sketched a little statement of our view of the law. Here it is. We have no requests for findings of fact or conclusions of law to offer, because we wanted to get the facts fully out and hear the testimony. Neither do I feel that we would like to be confined to this statement, somewhat hurriedly prepared last night, of our view of the law.

The Defendant offered no testimony.

Testimony Closed.

Mr. Pepper offered in evidence the following documents:

Form of Policy marked "Plaintiff's Exhibit No. 1-*a*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The
Penn Mutual Life Insurance
Company,
Philadelphia.

Name of Insured
Limited Life Policy
Premiums for Years
Date of Policy, 19
Yearly Premium, $
Payable Annually
Due the day of ."

112 Form of Policy marked "Plaintiff's Exhibit No. 1-*b*, December 28, T. R. P.," endorsed as follows:

"No. —.

The
Penn Mutual Life
Insurance Company,
Philadelphia.

Name of Insured
Endowment in Years
Amount, $
Date of Policy, 19
Yearly Premium, $
Payable Annually
Due the day of ."

Form of Policy marked "Plaintiff's Exhibit No. 1-*c*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The
Penn Mutual Life
Insurance Company,
Philadelphia.

Name of Insured
Ordinary Life Policy
Annual Dividends
Amount, $
Date of Policy, 191 .
Yearly Payment, $
Payable Annually
Due the day of ."

113 Form of Policy marked "Plaintiff's Exhibit No. 2-*a* December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance Company
Office, 921, 923 and 925 Chestnut St.,
Philadelphia.

Name of Insured
Date of Policy, 19
Amount, $
Endowment in Years
Five-year-option plan
Yearly Premium, $
Payable Annually
Due the day of

Form of Policy marked "Plaintiff's Exhibit No. 3-*a* December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance Company
Office, 921, 923 and 925 Chestnut Street,
Philadelphia.

Name of Insured
Amount, $
Ordinary Life
Life Rate Endowment
Yearly payment, $
Payable Annually
Due the day of ."

114 Form of Policy marked "Plaintiff's Exhibit No. 3-*b*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The
Penn Mutual Life
Insurance Company,
Philadelphia.

Name of Insured
Ordinary Life Rate
Endowment Policy
Annual Dividends
Amount, $
Date of Policy, 19
Yearly Payment, $
Payable Annually

Summary of life rate endowment, marked "Plaintiff's Exhibit 4-*a*, December 28, 1917, T. R. P.," reading as follows:

"See Schedule Page 39.

Life Rate Endowment.
Policy No. 330,393.
Issued June 8, 1906.
Amount $20,000.
Age 28.
Premium—$450.80.

Dividend Record.

1907	Dividend	$57.40	
	Interest	2.30	
'08	Dividend	58.20	
		117.90	
	Interest	4.72	
'09	Dividend.....	68.20	
		190.82	
	Interest	7.63	
'10	Dividend	77.40	
		275.85	
	Interest	11.03	
'11	Dividend	78.40	
		365.28	
	Interest	14.61	
'12	Dividend	87.60	
		467.49	
	Interest	18.70	
'13	Dividend	88.80	

Div. accumulations sur. to Co.....$574.99 6-19 ."

Summary of policy No. 330,393, marked "Plaintiff's Exhibit No. 4-*b*, December 28, 1917, T. R. P.," reading as follows:

"No. 330,393. Name..... Date 6-18-1906.

Age 28		Amt.		20,000	Kind,	L.R.E.	Prem. 4"
1907	Div.	57.40		275.85	574.99	Surrendered to Co. 6-8-1913	
	Int.	2.30		11.03			
'08		58.20	'11	78.40			
		117.90		365.28			
					See Schedule Page 39.		
		4.72		14.61			
'09		68.20	'12	87.60	Duplicate		
		190.82		467.49			
					Divs.....	516.00	
		7.63		18.70	Interest.....	58.99	
'10		77.40	'13	88.80		.....	
						$574.99"	

116 Form of Policy marked "Plaintiff's Exhibit 5*a*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The
Penn Mutual Life
Insurance Company
Philadelphia

Name of Insured

Year
Accelerated Endowment
Annual Dividends
Amount, $
Date of Policy, 19
Yearly Payment, $
Payable Annually
Due the day of ."

Form of Policy marked "Plaintiff's Exhibit 5-*b*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance Company
Office 921, 923 and 925 Chestnut Street,
Philadelphia.

Name of Insured
Rate of Policy, 19
Amount, $
New Accelerative
Endowment in Years
Yearly Premium, $
Payable Annually
Due the day of ."

117 Summary of Policy No. 265,957, marked "Plaintiff's Exhibit No. 5-*c*, December 28, 1917, T. R. P.," reading as follows:

"No. 265,957. Name ..... Date 4-28-'04

Age 32	Amt.		$2500	Kind, 25 E. Accelerative	
1905	7.37		59.58		
	.29		2.38		
'06	7.90	'11	13.63		
	15.56		75.59	See Schedule Page 50	
	.62		3.02	Divs.	'98.42
'07	8.47	'12	14.33	Interest	14.24
	24.65		92.94		112.66
	.99		3.72		
'08	9.07	'13	16.00		
	34.71		112.66	Surrendered 6-19-1913	
	1.39				
'09	9.70				
	45.80			Duplicate."	
	1.83				
'10	11.95				

Form of Policy marked "Plaintiff's Exhibit 6-*a*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance Company
Office 921, 923 and 925 Chestnut Street,
Philadelphia.

Name of Insured
Date of Policy, 189
Amount, $
Limited Life Policy
Accumulated Surplus Plan
Yearly Premium, $
Payable Annually
Due the day of "

118 Form of Policy marked "Plaintiff's Exhibit 6-B, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The
The Penn Mutual
Life Insurance Company
Philadelphia.

Name of Insured
Limited Life Policy
Accumulated-Surplus Plan
Amount, $
Date of Policy, 19
Yearly Payment, $
Payable Annually
Due the day of ."

Summary of Policy No. 232,579, "Accumulated Surplus," marked "Plaintiff's Exhibit No. 6c, December 28, 1917, T. R. P.," reading as follows:

"1903
A

Age 39 Accumulated Surplus $1000.

No.	Amt.	Date of Issue		Yr.	Amt. Ins.	Total Acc. Div.
232,579.	1000.	Mch. 1903	5.00	'04	84.77	
			.20		3.39	
			5.87	'05	16.81	'12
			11.07		17.95	S. Forf
			.44			
			6.78	'06		
			18.29		122.92	
			.73		4.92	
119			7.73	'07	18.07	'13
	Duplicate		26.75		145.91	
			1.07		Sched-	
			9.87	'08	ule	
			37.69		page	
			1.51		27	
			10.94	'09		
			50.14			
			2.01			
			14.34	'10		
			66.49			
			2.66			
			15.62	'11		
			84.77			

"Plaintiff's Exhibit 6-*d*, December 28, 1917, T. R. P.," reads as follows:

"See Schedule Page 27.

Accumulated Surplus.
Policy No. 232,579.
Issued Mch. 2, 1903.
Amount $1,000.
Age 39
Premium $107.20.

Dividend Record.

1904	Dividend	5.00	
	Interest	.20	
'05	Dividend	5.87	
			11.07
	Interest	.44	
'06	Dividend	6.78	
			18.29
	Interest	.73	
'07	Dividend	7.73	
			26.75
	Interest	1.07	
'08	Dividend	9.87	
			37.69
	Interest	1.51	
'09	Dividend	10.94	
			50.14
	Interest	2.01	
'10	Dividend	14.34	
			66.49
	Interest	2.66	
'11	Dividend	15.62	
			84.77
	Interest	3.39	
'12	Dividend	16.81	
	Share Forf.	17.95	
			122.92
	Interest	4.92	
'13	Dividend	18.07	
	Mat'd and paid Mch. 1913	145.91	

See Schedule Page 27

Dividends	111.03
Interest	16.93
Share Forf.	17.95
	$145.91."

120

121 Form of Policy marked "Plaintiff's Exhibit No. 7-*a*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance Company
Office 921, 923 and 925 Chestnut Street,
Philadelphia.

Name of Insured
Date, 189
Amount, $
Investment Bond.
Endowment in Years
Yearly Payment, $
Payable Annually
Due the day of ."

Form of Policy marked "Plaintiff's Exhibit 7-*b*, 12-28,1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance Company
Office 921, 923 and 924 Chestnut Srteet,
Philadelphia.

Date of Policy, 19
Amount, $
4% Endowment Investment Bond
Endowment in Years
Yearly Premium, $
Payable Annually
Due the day of ."

122 Form of Policy marked "Plaintiff's Exhibit 8-*a*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The
Penn Mutual Life
Insurance Company
Philadelphia.

Name of Insured
Endowment in Years
Guaranteed Dividend Investment Plan
Amount, $
Date of Policy, 19
Yearly Premium, $
Payable Annually
Due the day of ."

Form of Policy marked "Plaintiff's Exhibit 8-*b*, December 28, 1917, T. R. P.," endorsed as follows:

"No. —.

The Penn Mutual
Life Insurance
Company
Office
921, 923 and 925 Chestnut Street,
Philadelphia

Name of Insured
Amount, $
Ordinary Life
Guaranteed Dividend Investment
Policy
Date 189
Yearly Payment $
Payable Annually
Due the day of ."

123 Summary of four per cent. investment bonds marked "Plaintiff's Exhibit No. 9, December 28, 1917, T. R. P.," reading as follows:

4% Investment Bond
Policy No. 236,620
Issued Apr. 25, 1903
Amount, $2500
Age 49
Premium, $280.15
Dividend Record
Amount of Divs. 329.98
Amount of Int. 53.08
Share of forfeitures 43.67

See Schedule Page 36

Matured and paid Apr. 1913.....426.73

6% Bond.

Policy No. 51704
Issued Mch. 15, 1888
Age 30
Amount $1000
Premium 47.65
Dividend Record
Amount of Divs. 132.85
Amount of Int. 121.45
Share of Forfeitures 103.15

See Schedule Page 37

Matured and paid March 1913.....357.45

Guaranteed Dividend.

Policy No. 89,170
Issued 4-5-1893
Age 29
Amount $2500
Premium 78.15
Dividend Record
Amount of Divs. 174.90
Amount of Int. 94.52
Share Forfeitures 62.57

See Schedule Page 33

Matured and paid — 1913 .....331.99."

124 **Plaintiff's Exhibit No. 10.**

1913 **Summary of Divisions of Interest, forfeitures and premiums, marked "Plaintiff's Exhibit No. 10, December 28, 1917, T. P. R.", reading as follows:**

KIND	INDIVIDUAL DIVS.	INTEREST	SHARE FORF.	TOTAL	LAST PREMIUM	RECEIVED PRIOR TO 1913	RECEIVED 1913
A's Policies							
Jan. & Feb.	$ 42,998.07	$ 18,772.75	$ 13,674.17	$ 75,444.99	$ 25,780.31	$ 23,998.52	$ 1,781.79
Mch-Dec.	195,870.77	76,068.59	58,112.08	330,051.44	117,615.69	100,231.79	17,383.90
Jan.-Dec. inc.	$238,868.84	$ 94,841.34	$ 71,786.25	$405,496.43	$143,396.00	$124,230.31	$ 19,165.69
Guar. Divs.							
Jan. & Feb.							
Mch-Dec.	$ 20,945.63	$ 10,912.14	$ 7,880.19	$ 39,737.96	$ 9,256.84	$ 6,872.77	$ 2,384.07
Jan.-Dec.	$ 20,945.63	$ 10,912.14	$ 7,880.19	$ 39,737.96	$ 9,256.84	$ 6,872.77	$ 2,384.07
4% I. Bond							
Jan. & Feb.	$ 4,586.22	$ 2,031.96	$ 1,337.76	$ 7,955.94	$ 3,112.35	$ 3,112.35	
Mch-Dec.	25,998.28	10,969.82	6,568.13	43,536.23	14,059.82	12,750.64	$ 1,309.18
Jan.-Dec.	$ 30,584.50	$ 13,001.78	$ 7,905.89	$ 51,492.17	$ 17,172.17	$ 15,862.99	$ 1,309.18
6% Bond							
Jan. & Feb.	$ 2,906.07	$ 2,356.40	$ 2,012.57	$ 7,275.04	$ 1,299.91	$ 1,299.91	
Mch-Dec.	12,340.87	10,353.98	9,816.27	32,511.12	4,218.23	2,777.16	$ 1,441.07
Jan.-Dec.	$ 15,246.94	$ 12,710.38	$ 11,828.84	$ 39,786.16	$ 5,518.14	$ 4,077.07	$ 1,441.07
L. R. End't							
Jan. & Feb.	$ 7,752.94	$ 4,203.90		$ 11,956.84	$ 15,898.06	$ 3,554.97	$ 12,343.09
Mch-Dec.	38,374.18	19,732.66		58,106.84	88,385.84	13,658.29	74,727.55
Jan.-Dec.	$ 46,127.12	$ 23,936.56		$ 70,063.68	$104,283.90	$ 17,213.26	$ 87,070.64
Acce'l End't							
Jan. & Feb.	$ 738.01	$ 61.71		$ 799.72	$ 1,899.47	$ 682.45	$ 1,217.02
Mch-Dec.	8,289.28	755.48		9,044.76	20,019.97	4,753.40	15,266.57
Jan.-Dec.	$ 9,027.29	$ 817.19		$ 9,844.48	$ 21,919.44	$ 5,435.85	$ 16,483.59
6's							
Jan. & Feb.	$ 11,691.89	$ 3,105.06		$ 14,796.95	$ 9,507.82	$ 4,384.84	$ 5,122.98
Mch-Dec.	51,944.95	14,257.01		66,201.96	42,841.33	23,763.20	19,078.13
Jan.-Dec.	$ 63,636.84	$ 17,362.07		$ 80,998.91	$ 52,349.15	$ 28,148.04	$ 24,201.11
Final Divs.							
Jan. & Feb.	$ 10,441.14			$ 10,441.14			
Mch-Dec.	74,151.44			74,151.44			
Jan.-Dec.	$ 84,592.58			$ 84,592.58			
Full Pd Divs.							
Jan. & Feb.	$ 1,935.21			$ 1,935.21			
Mch-Dec.	14,846.69			14,846.69			
Jan.-Dec.	$ 16,781.90			$ 16,781.90			
Trust Certif.							
Jan. & Feb.		$ 3,272.95		$ 3,272.95			
Mch-Dec.		15,540.59		15,540.59			
Jan.-Dec.		$ 18,813.54		$ 18,813.54			
Totals							
Jan. & Feb.	$ 83,049.55	$ 33,804.73	$ 17,024.50	$133,878.78	$ 57,497.92	$ 37,033.04	$ 20,464.88
Mch-Dec.	442,762.09	158,590.27	82,376.67	683,729.03	296,397.72	164,807.25	131,590.47
Jan.-Dec. inc.	$525,811.64	$192,395.00	$ 99,401.17	$817,607.81	$353,895.64	$201,840.29	$152,055.35

125 Schedule of Dividends, etc., Penn Mutual Life Insurance Company of Philadelphia, Return to Comptroller's Department, 1913, marked "Plaintiff's Exhibit A., December 28, 1917, T. R. P."

Schedule of Divisions left with Company at Interest, Penn Mutual Life Insurance Company of Philadelphia, return to Comptroller's Department, marked "Plaintiff's Exhibit B., December 28, 1917, T. R. P."

Original return of the Penn Mutual Life Insurance Company to the Collector of Internal Revenue for the Calendar year of 1913, marked "Plaintiff's Exhibit C., December 28, 1917, T. R. P."

And thereafter, to wit: on February 4, 1918, Hon. O. B. Dickinson, the Judge before whom the case was tried, filed an opinion as follows.

Opinion.

Sur Trial Hearing Before the Court Sitting Without a Jury.

Filed Feby. 4, 1918.

DICKINSON, *J.*:

Trial by jury was by stipulation made in accordance with the Acts of Congress on the subject, waived by the parties.

The facts, in the sense of the evidentiary facts, are not in controversy, nor indeed is there much, if any, conflict over the ultimate fact findings. The case is really one involving only a question of law arising out of differences in the interpretation of the Revenue Act of October 3rd, 1913, and is to all substantial intents and purposes a case stated. The atmosphere in which, under the present war conditions, every responsible interpreter of revenue laws finds himself, induces a disposition to incline to that interpretation of the revenue laws which will result in producing revenue. Congress, however, is to be presumed to have been influenced by a like
126 attitude and to have taxed everybody and everything which were deemed proper subjects of taxation. There is, in consequence, no call upon the Courts to extend by construction the taxable lists as made up by Congress. Neither of these observations, however, involves the thought of a change in the proper rule of the construction of statutes. We have been reminded by counsel for the plaintiff that the accepted rule is, as the doctrine is sometimes phrased, "that taxing statutes are to be strictly construed." Care must be exercised in the use of this phrase, as of all other general expressions, so as not to permit the true doctrine to be misunderstood. It does not mean, as it is sometimes thoughtlessly assumed to mean, that the Courts in construing such statutes should lean strongly toward the taxpayer, and add the weight of all their power and authority to a resistence to the collection of the tax. The doctrine is more fundamental and has an historical basis to be found in the political history of our people. It is the American doctrine that the people govern themselves, and a vital part of that principle is

that they and they only tax themselves. No tax can in consequence be imposed except by their representatives in Congress, and a further negative consequence is that no tax can be imposed by the Courts or the Executive, through judicial or administrative construction of Statutes. This is the sense in which tax laws are to be strictly construed. When, however, Congress has indicated its purpose and intent to tax, the tax must be paid, and the Courts cannot refuse to enforce that purpose and intent merely because, in the expression of its will, Congress has failed to dot or to cross some of the letters which make up the written words in which that mandate is recorded. In this sense laws for the raiding of revenue are not to be strictly construed but are to be given that construction which is given to remedial statutes. In other words, the doctrine is a broad and not a picayune one.

With this prelude, we come to the reading of this Statute.
127 It clearly contains the general command to this plaintiff, and other like corporations, to pay a tax. We cannot understand just what payment is commanded to be made unless we first understand what these corporations are and the nature of the business which they transact. This is in an emphatic sense part at least of the subject matter of the law. It will be found that they are somewhat complex in character and their business partakes of a like complexity.

The "mathematician" of the plaintiff has presented this phase of the question in a very intelligible and clear cut way by presenting groups of typical transactions in a numbered series, so that we can get, at almost one glance, a view of all of the phases which the general question presents. It will contribute something to our clarity of view if we take up one by one the consideration of each of these elements into which the character of these corporations and the general business they do may be analyzed.

In the first place, they are insurance companies, but they are as well mutual insurance companies. This means they receive premiums but these premiums are limited to the actual cost of the insurance. The practical conduct of such a business requires of them to exact the advance payment of an estimated reasonably safe maximum premium, and to return to the policy holders the excess after the actual cost of the insurance is known. This may be and is properly done annually. The elements which go to make up this excess we do not see to be of importance although they do have some illustrative value. The practical working of this plan makes evident a result which is indeed suggested by the plan itself that the premium receipt and the excess return seldom take place within the limits of the same fiscal or calendar year, although a year would measure the time interval. The receipt of the advance premium suggests the further thought which actual practice confirms that the policy holder may not desire the return of his excess refund but may
wish to apply it to what is called "the purchase of additional
128 insurance." To provide for this the contract has engrafted upon it the thought of the fact amount payable under the policy automatically increasing accordingly. Although called (and properly so) life insurance companies, they do not always adhere strictly to this plan, but it is modified to the extent of being made an in-

surance not against death but against death occurring within a named term of years and the insured sum becoming payable at the end of the period. The language of life insurance thus comes to furnish us with the terms—plain life and endowment policies. The essentials of the plain are not, however, changed by this.

At this stage in the recital of what is done, the hearer would doubtless be impressed with the thought that the policy holder having once made his elections was bound by it and could not afterwards demand the refund to which he would have otherwise been entitled. Whatever the contractual or other right of the company to retain the money, it does not (and the motive for this is apparent) insist upon but accords the free right of the policy holder to withdraw at any time the whole or any part of what we will call his "deposit." The use of this word serves to present the thought that the company having these deposit moneys has put them at work and there is in consequence an accretion by way of interest or other profits and that this also belongs to the depositor. The companies thereupon become or partake of the nature to this extent of savings funds companies, and are subjected to the administrative expenses which are thereby incurred. The introduction of paid-up policies and other forms of matured insurance contracts in which there is the thought of the maturing in the sense of the fixing of the obligation to pay at a future time without further premium payments, and also in the sense of the obligation to pay at once, adds to these companies some of the characteristics of building associations, and the leaving with the company of insurance moneys then demandable with the allowance of interest thereon or other return; the issue of trust
129 certificates and the added features to policies of not paying a round sum to the beneficiary but granting him an annuity instead, as well as other modifications of the simple life insurance contract, all give such a complexity to the character and business of these companies such as that even and otherwise concise statement of them would run into undue length.

One other of such modified forms of contract does, however, have perhaps a direct relation to the legal question before us. These companies, to the extent to which their practical dependence upon the laws of the different States in which they do business will permit, make of themselves managers of a lottery. This springs from the issuance of tontine, semi-tontine and other modified forms of what is known as tontine insurance. The essential thought is that these accumulations of moneys in part contributed by a given group or class of policy holders and in part accretions to the moneys thus contributed are shared in whole or part not by the contributors but the persistent livers and premium payers among them. Their title, such as it is, is by right of survivorship.

This gives us a sufficiently adequate idea of the corporations which Congress sought to tax and of the business done by them. Let us, in further aid to a proper interpretation, attempt to get the viewpoint of the draughtsman of the Act. What may be called the first or original draughtsman had evidently a clear cut, well defined idea of whom and what he intended to tax, and had in mind an orderly and logically developed method of reaching the amount of the tax.

What he had in mind to tax was what is understood by the phrase "net income." To reach this he took into account gross income, excluding therefrom, however, certain elements or items and from this remainder he permitted to be deducted certain other to be clearly defined elements or items, and the balance was to be the taxable net income. This distinction between what was to be excluded by not being included in gross income and what was to be deducted from the gross income thus stated was preserved
130 throughout what may be recognized as the original draft of the Act. A mere verbal contract of "not including" with "deducting" would call for the comment of "distinction without difference," but there is none the less a real practical difference worked through and by the distinction. The distinction, however, works no difference in the final result of determining the amount of the tax. It has moreover not been always clearly observed throughout the whole Statute. We find the departure in some of the provisos of the Act. We have the right to call upon our knowledge of the practical workings of legislation for the explanation of this. Further "exclusions" or "deductions" than those appearing in the original draft were suggested. These took the form of being expressed after the phrase "Provided further" or equivalent words. As the result was the same the distinction was to some extent lost and was dropped in some of the provisos. This explanation, if a probably good one, is of some aid to us because the distinction is clearly observed in dealing with Marine Insurance Companies, and is not observed, or at least so clearly observed, in the next following clause which deals with Mutual Life Insurance Companies.

This doubtless unduly long explanation brings us at last to the Act of Congress to be construed. The clause is:

"Provided, further, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policy holders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policy holder as shall
131 have been paid back or credited to such individual policy holder, or treated as an abatement of premium of such individual policy holder, within such year."

This clause relates to mutual marine insurance companies and to mutual life companies. The part of the proviso which relates to the former is admittedly sufficiently clear in the expression of its meaning. What it means and the effect of such meaning upon the clause relating to life companies will be considered hereafter. Reading the latter clause by itself in the sense of an enactment removed from its setting and away from the light afforded by the context, it may be read as counsel for plaintiff reads it. If we grant that it may also be read as counsel for the United States reads it, the decision to be made is presented. To decide it we may adopt the corrective caution of the old surveyors which golfers follow upon the

putting greens. We will thus seek to verify or correct the foreview by reversing the line of sight and by taking a hindsight. So viewed, the clause reads that moneys which have within the year been paid back to policy holders or so treated shall not be included in the gross income return of the companies, if such moneys were previously received from the policy holders as premiums. When so read it becomes clear that the clause cannot be given the meaning which the United States gives to it without adding an expression of the thought that the moneys so paid back within the year shall have also been received within the year. If the right to add this further thought or make this interpolation be denied to the reader, then the clause must be read as counsel for the defendant reads it, it wit: that all moneys which have been paid back to the policy holders within the year shall be excluded from gross income, if these moneys shall have been previously received for premiums, whether received during the year or not.

Recurring now to the marine clause, the two classes of corporations will be found in this respect to be put upon the same footing, except in certain particulars, one of which is that the return
132 premiums paid on marine policies are deducted from the total income, and those paid on life insurance contracts are excluded from gross income. Although it is of course true that an Act of Congress must be accepted for the purpose of interpretation in the form in which it was finally passed and cannot be altered or amended so as to conform to the meaning given to it by an individual member who advocated its passage or by a committee which may have discussed it, in a report nevertheless the expression of opinion thus given is entitled to weight by any one called upon to judicially construe the law. This is for two reasons. One is that such an expression of opinion should be given the weight which is given to the opinions of text writers, members of the Bar, and the obiter dicta of Judges. Another is that such an expression of opinion makes clear that a construction which is in accord with such opinion is neither a strained construction nor an afterthought because it is evident of a contemporaneous construction given to the law at the time of its passage. We know from the records of Congress that the committee reporting the Bill, in discussing the clause in question which had been added to the Bill in committee reported to the House that the purpose of adding the clause was to place life insurance companies on the same footing as marine companies. The weight of the opinion thus expressed is felt.

The thought thus inadequately expressed leads to the conclusion from a statement of which the thought itself can be more clearly gathered, that the defendant had the right to exclude from its statement of gross income for any year all moneys which within that year it had returned to policy holders, provided the moneys thus excluded were parts of the moneys which had been previously paid to the company for premiums, whether they had thus been received by the company within the year or before.

We are led to this conclusion because, to re-express the same thought, we cannot get the meaning out of the clause which
133 the United States gets out of it without adding to the clause something which is not in it. In other words, the Act of

Congress says to the plaintiff the moneys which you exclude must have been paid back to the policy holders within the same year from the return for which you have excluded them. That is in the Act. The moneys you exclude must have been previously paid to the company by policy holders for premiums. This also is in the Act. Finally, the moneys must have been thus paid to the company "within the same year." It is this final thought which is not in the Act. When, however, we come to what is to be thus excluded, we find another difference between the returns which marine and life companies are respectively to make. Marine insurance companies are to deduct not only the premiums thus repaid but also all accretions by way of interest to the unused premiums while in the hands of the company. This is expressly stated. In the case of life companies, there is not only an absence of any equivalent expression but it is expressly stated that the excluded sum shall be limited to such portion of the "actual premium" as shall have been both received and paid back.

The conclusion asked to be drawn from this is that all accretions to the fund which is left with the company during the interval between the receipt and return of the premiums should not be included from gross income but remain to swell the sum of the gross income return and thus be made to swell the taxable net income.

Confirmation of the soundness of this second finding asked to be made is thought to be found in an earlier provision of the Act which forbids the taxable income to be reduced (and this is meant to cover both "exclusions and deductions") by "dividend" payments. The phrase is "sums other than dividends paid within the year on policy, and annuity contracts" shall not be included in taxable income. The clear implication is that there shall be no deductions because of "dividend" payments. As readers and hearers we should
134 be ever on guard to prevent our minds playing any tricks upon us by being affected by what a famous writer has happily called the "polarization of words." The word "dividends" partakes somewhat of the character of such words. To the ears of those fortunate enough to be placed within hearing distance of the work, it has a pleasant sound suggestive of the "cutting of a ripe melon." It means a share of profits. Sums so paid of course should neither be "excluded" nor "deducted" in the ascertainment of net income. Such "dividends" means merely the distribution of the whole or part of the "net income" to the happy individuals who have a right to share in it. As a consequence, counsel for defendant manifest an inclination to dwell upon the word "dividend" and to speak of what policy holders receive as a "dividend." Counsel for plaintiff show a tendency to avoid the use of the term, or when they do employ it, they are fond of qualifying it by a slighting phrase. It is a "so-called" dividend. We do not share either in this fondness for or aversion to the use of the word. It is clear that the profit sharing thought is altogether an applied meaning which the word at times properly has. It may, however, be properly employed when the thought of profit is wholly absent and the word has its etymological meaning of a unit portion of something which has been

divided. The confirmation claimed, however, loses all its value when we find that in making up the return of mutual insurance companies they are directed to exclude from gross income the dividends referred to, and having been once "excluded" they are not later to be "deducted," because this would result in an undue because doubled reduction to that extent in the final sum reached.

Disregarding the confirmation of the thought and coming back to the thought itself, there is this to be said. The income of mutual life companies has as its first source premium payments advanced by policy holders. The temporary possession of the fund thus accummulated and the non-return to some policy holders supplied a second source of income through accretions to this temporary fund by way of interest or other profit. In consequence, the moneys returned to policy holders may be said to be not the return of a portion of the "actual premiums," payment of which they had previously made, but as made up in part, or indeed perhaps wholly, of the policy holder's share of profits. As, however, the basis of the payment finally exacted of the policy holder is his share of the net cost of insurance, had this cost been known in advance of payment the sum paid would have been less than was paid, and this difference, when returned to him, may well be said to be a return of a portion of the "actual premium" paid. The real truth is that what is done is not done so that any trace is left of the process, but it is one of those things done of which we may have a mental concept as done in one way or done in another. The best answer to the question of whether the policy holder receives back a portion of the "actual premium" paid by him or whether he receives part of the profits which his company has earned can be given by expressing a concept of what was done such as to present the substantial results of what was done. The thought is expressed by the phrase to which there is a common resort when confronted with such a dilemma. The phrase is "that is what it comes to" or "amounts to." The decision of the question partakes more of the nature of a rescript than a reasoned result, but the necessity of reaching such more or less arbitrary conclusion is forced upon us. We have a sufficiently clear indication of the will of Congress with respect to marine insurance companies.

135

Speculation would be idle over why Congress differently expressed its will in the case of life insurance companies if like treatment was meant to be meted out to both. The words of the Act, however, may be so read and there would seem to be good grounds of belief that Congress so intended.

The view we have expressed is in accord with the ruling made in Mutual vs. Herold, 198 Fed., 199, affirmed in 201 Fed., 918. We think it is to be assumed that this ruling was in the mind of Congress when it came to choose its words in the Act of 1913 and again in 1916.

136

It thus appears that the payment of more than the lawful tax was exacted of the plaintiff. If this be true, we understand it to be conceded that the plaintiff is entitled to judgment, so that no other features of the plaintiff's case need be considered.

The discussion of the questions involved in this case is doubtless

already overfull. We find ourselves, however, in disagreement with the views of those who have to do with the administration of these tax laws, and with the views of counsel who have given to their study much more thought and time than is possible to give to them in the press of litigation. Because of this, we think it the due of counsel that the several positions at which they take their stand should be squarely faced, even at the cost of a repetition of our views. As a prelude this may be stated. Back of the whole discussion is the fact that moneys which have been received but which are required to be returned, if returned form no part of real income. The taxing authority need not recognize the propriety of a reduction merely because there is an obligation to return. Several very practical considerations would support this refusal When, however, the obligation to return has ripened into an actual return, and both the return and the amount of the return become fixed facts, the supports of such refusal are removed. There is really no difference in the basic thought presented by the respective counsel and sought to be contracted. The difference is in the practical results following different modes of applying the thought. The thought springs out of the fact, already several times stated, that the policy holders make a deposit out of which the moneys required to meet the cost of insurance are taken and the overplus is returned. The part retained is properly income received; the part returned is in no real sense either income or received. So far there is agreement.
137 Counsel for the United States, however, in applying this basic thought present three sub-thoughts.

1. Unless the part returned is returned in the same year in which it was received, it is to be treated as not returned at all.

2. Deposits thus made before the passage of the Act are separated as by a wall from deposits afterwards received and no draughts made upon these earlier deposits to reimburse policy holders for any excess in such deposits can be permitted to affect (reducing) the income later received.

3. The fact that the deposits have been swelled, while with the company, by interest, by tontine and by other accretions, results in demanding the finding that the moneys returned to policy holders are not moneys previously paid by them but (in part at least) profits or earnings made by the company and distributed among its stock holders which the policy holders then become.

The three positions thus taken involve propositions which have already been discussed, but in order to squarely meet them, we will summarize the views already indicated.

1. The arguments of both plaintiff and defendant partake of the nature of arguments which are more properly addressed to Congress than to the Courts. Each is planted, to some extent, upon what may be deemed the principles of natural justice. Plaintiff urges the inequity, if not iniquity, of double taxation. Defendant points out that the taxpayer is seeking to escape the payment of taxes by reducing an income, subject to the tax, by claiming reduction which

properly lessen not the income, which is subject to the tax, but an earlier income, which is not subject to the tax. The judicial inquiry it is clear, is not into what enactment Congress should have made after a just balancing of these considerations but into what enactment Congress did in fact make. Our conclusion or finding of what Congress did do has already been several times stated, but we restate it so it will here appear. The gross income is to
138 be reduced by the amount of premiums returned, if previously received, no matter when received.

2. Our finding upon the second point need not be further discussed than by its restatement. A distinction might well be made between the return of premium receipts, which have never figured in taxable income because received before the Act, and those which have been since received. Because, however, the distinction might have been made or indeed well made, it does not follow that it was made. In determining whether it was made, we may fall back upon the principle that the Act is to be construed, as a system of taxation, as if it had always been in force and had never had a beginning. It is further to be assumed that if Congress had not had in mind that this principle was to be applied they would have so enacted. The conclusion reached is that Congress has made no distinction between the income return for the first year (or the ten months part of the year) and the returns for the succeeding years.

3. The third proposition is open to the same comment. There is, it must be admitted, a more or less arbitrary choice made, in the acceptance of either of the two concepts of what it is which is returned to policy holders—whether it is a return wholly of a portion of the premium deposits previously made by them or whether it is in whole or part a distribution of profits among them. The choice we have made is not however wholly arbitrary, because we have chosen that one which is in harmony with the other concept of a mutual life insurance company as an association of policy holders who insure themselves by ultimately paying the net cost of carrying their own life risks, although for very practical reasons they pay down in advance a round sum which would be limited to this actual cost, if the cost were known at the time of payment. Not being so known, they pay a sum large enough to safely cover it, with the understanding that the excess will be returned to them. So
139 viewed, what they get back is a part of what they have previously paid.

This in principle decides the case before us. We do not have at hand the figures expressive of the sum for which plaintiff is entitled to judgment, in accordance with the general findings made, nor have we been informed whether counsel ask for special findings. There was an unavoidable interval between the trial and the consideration of the briefs submitted. It may be that there are features of the case which enter into the ascertainment of the sum for which judgment should be entered, which the above discussion does not cover, and which would affect the amount of the judgment. To meet this situation counsel have leave to submit requests for findings

from which the amount for which judgment should be entered can be determined, together with any requests for special findings they may wish to submit, if any. Formal judgment will then be directed to be entered.

And thereafter, to wit: on March 20, 1918, the Plaintiff filed the following requests for findings of fact and law:

Plaintiff's Requests for Findings of Fact.

(Filed Mar. 20, 1918.)

1. On June 29, 1914, the Plaintiff paid to the Defendant the sum of $11,382.79. This was the amount admitted by the Plaintiff to be due for the year 1913.

2. On the same date, to wit, June 29, 1914, the Plaintiff paid to the Defendant $6,865.03. This payment represented so much of the tax assessment for the last ten months of 1913 as was claimed by the Plaintiff to be excessive and illegal. The payment in question was made uider protest and under duress of threat of collection by distraint and sale of Plaintiff's property.

140 3. The said sum of $6,865.03 represents one per cent. (1%) upon the following items alleged by the Defendant to be taxable but claimed by the Plaintiff not to be taxable:

(1) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question provided in effect that after a certain number of premium payments the insurance should continue without any further payments by the insured, i. e., that the policy should become a full paid policy. Other contracts of insurance, written on the endowment form and outstanding during the tax period in question, provided in effect that the insured should be entitled to receive from the Plaintiff a final share of surplus at the time of the receipt by him of payment of the sum insured. Still other contracts of insurance outstanding during said period provided in effect that upon payment of the sum insured as a death claim there should be paid also the final share of surplus to which the policy holder was entitled. In all these three cases the sums paid to the insured represented so much of premium payments to the Plaintiff previously made by the insured as proved to be in excess of the cost of carrying the insurance. The aggregate of payments thus made by the Plaintiff during the last ten months of 1913 under policy contracts of these three types was $74,151.44.

(2) Certain of Plaintiff's contracts of insurance issued upon the Limited Payment Life plan provided that, when all the premiums thereunder had been settled and the policies had thereupon become full paid should participate in future surplus of the company in accordance with their contribution. Such dividends are the outgrowth of redundant premiums paid in former years, and the product of such previous excess premium payments actually repaid by the

Plaintiff to policy holders in this group during the tax period in question was $14,846.69.

141 (3) Certain of Plaintiff's contracts of insurance outstanding during the tax period in question provided in effect that annual dividends awarded to the insured should be retained by the company during five year periods under what are known as Five Year Option Policies. Such dividends are portions of premiums paid by the insured and subsequently proved to be in excess of the cost of carrying the insurance. These excess premium payments, while remaining in the hands of the company, earn interest, and the amount of interest thus earned by each policy holder's excess payment was included in the sum repaid to him. The total of these dividends paid during the last ten months of 1913 amounted to $51,944.95, and the interest accretions on this fund paid over to the policy holders whose premium payments had produced them was $14,257.01, a total of $66,201.96.

(4) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued upon what was known as the Life Rate Endowment plan, whereunder life premiums were payable, the amount of the policy maturing in favor of the insured when the legal reserve under the contract, plus its accumulated dividends, equaled the face. It was also provided that such accumulated shares of surplus might be used to settle premiums or might be withdrawn in cash, in which cases the endowment feature was deferred. Such dividends of surplus are portions of premiums theretofore paid which have proved to be redundant or excessive and which have been earning interest while in the hands of the company for the benefit of the insured. The aggregate of these dividends during the tax period mentioned was $38,374.18, and the interest payments yielded by them were $19,732.66, a total of $58,106.84.

(5) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued upon what was
142 known as the Accelerative Endowment Plan, the maturity of which was accelerated by the insured permitting his annual shares of surplus to remain in the custody of the company and to be increased by the addition of their own interest earnings. These were redundant portions of premiums theretofore paid. These repayments were made up of redundant premiums amounting to $8,289.28, together with interest earnings of $755.48, a total of $9,044.76.

(6) Certain of Plaintiff's contracts of insurance outstanding during the tax period in question provided in effect that all dividends should remain with the company under a form of insurance known as Accumulated Surplus during selected periods, upon what has been known as the Semi-Tontine plan. In accordance with this plan policy holders who persisted in the payment of premiums and survived their respective accumulating periods participated in the accumulated dividends of the members of their respective classes who had meanwhile died or discontinued premium payments. These

payments were made up of three elements: first, excessive premium payments made by policy holders of the class in question; second, interest items earned by the excessive payments in the interval between their receipt by the company and repayment to the insured; third, the proportionate share of the surplus, with its corresponding interest earnings, set free for the benefit of the persistent survivors by the death or lapse of some members in the class in question. The total of such dividends amounted to $195,870.77, their interest earnings were $76,068.59, and the sums set free by death or lapse as aforesaid were $58,112.08, a total of $330,051.44.

(7) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued as a modification of the Deferred Dividend plan, known as the six per cent bond, whereunder the dividends were accumulated in the hands of the company at interest. Such contracts contained a provision that should the insured die within twenty-five years there should be paid, in addition to the sum insured, an amount equal to six per cent thereof, or $60.00 per thousand, which was paid for by the insured at term rates. At the completion of the twenty-fifth year, in which case (in addition to the sum insured) there was a payment to the insured of the accumulated dividends with the interest which they had earned and a share of the surplus with its interest accretions set free by death or lapse of the members of the class. The total of such dividends amounted to $12,340.87, their interest earnings were $10,353.98, and the sums set free by death or lapse as aforesaid were $9,816.27, a total of $32,511.12.

143

(8) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued as four per cent bonds, which provided in effect that at the maturity of the selected endowment period the insured could permit the amount of his policy to remain with the company, subject to a four per cent interest addition, which could also be withdrawn at anniversaries. The total of such dividends amounted to $25,998.28, their interest earnings were $10,969.82, and the sums set free by death or lapse were $6,568.13, a total of $43,536.23.

(9) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued upon what was known as the Guaranteed Dividend plan, which provided in effect that in the event of the death of the insured, before the termination of his accumulated surplus period, there should be paid by the Plaintiff a definite proportion of his total premium payments, which sum so paid represented the proceeds of term insurance upon the life of the insured and paid for by him at term rates. Should he survive the accumulated surplus period the insured was entitled to a repayment of his previous excess premium payments together with their interest earnings and his proportionate share of surplus and interest accretions set free by the death or lapse of other members of the class. The total of such dividends amounted to $20,945.63, their interest earnings were $10,912.14, and the sums set free by death or lapse were $7,880.19, a total of $39,737.96.

144

(10) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued as Trust Certificates, which provided in effect for an income to the beneficiary of a certain proportion of the sum insured, payable at fixed intervals during a stipulated period. Under policy contracts of this type the unpaid balance remaining in the hands of the company earns interest for the benefit of the beneficiary which is paid to him at the several periods of maturity specified in the policy, together with the instalment benefit payable to the beneficiary at such date. The amount of such interest earnings during the tax period mentioned was $15,540.59.

(11) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued with what was known as an Interest Privilege, whereunder redundant premiums are retained by the company at a specified rate of interest, later withdrawals at the option of the insured. The totals of such dividends during the tax period mentioned was $2,644.15, and the interest earned thereon $130.20, a total of $2,774.35.

4. On or about the 13th day of July, 1914, the Plaintiff filed with the Defendant a claim for refund of the tax so paid insofar as it was excessive and illegal, to wit, to the extent of $6,865.03. The said claim for refund was accepted by Defendant, but was subsequently rejected by the Commissioner of Internal Revenue.

145

G. W. PEPPER,
Attorney for Plaintiff.

Plaintiff's Requests for Findings of Law.

(Filed Mar. 20, 1918.)

1. The amount of the tax paid by the Plaintiff to the Defendant on June 29, 1914, was, to the extent of $6,865.03, excessive and was unjustly and illegally assessed against the Plaintiff by the Commissioner of Internal Revenue, and was illegally and wrongfully collected from the Plaintiff by the Defendant.

2. All interest items and all payments representing forfeitures or lapses included in the principal sum, of which $6,865.03 was the tax percentage, were sums other than dividends paid by the Plaintiff within the year on policy contracts within the meaning of section 12 of the Act of Congress approved September 8, 1916.

3. The Plaintiff is entitled to recover the sum of $6,865.03, together with interest thereon from June 29, 1914, and judgment is directed to be entered for this amount in favor of the Plaintiff and against the Defendant.

G. W. PEPPER,
Attorney for Plaintiff.

And the defendant filed the following Requests for findings of Fact and Law:

Finding of Fact Requested by Defendant.

(Filed on Mar. 20, 1918.)

The amount $6,865.03, which the Plaintiff claims was illegally assessed and collected, was made up of $27.74, which De-
146 fendant admits was illegally assessed and collected; $4,427.62, tax on dividends accruing in previous years; $1,585.90, tax on interest on dividends; and $823.77, tax on forfeitures.

FRANCIS FISHER KANE,
United States Attorney.

Conclusions of Law, Requested by the Defendant.

(Filed Mar. 20, 1918.)

1. That the sum of $4,427.62, paid as a tax on account of dividends accruing in previous years, was legally assessed against the Plaintiff by the Commissioner of Internal Revenue, and legally and properly collected from the Plaintiff by the Defendant.

2. That the sum of $1,585.90, paid as a tax on account of interest and dividends, was legally assessed against the Plaintiff by the Commissioner of Internal Revenue, and legally and properly collected from the Plaintiff by the Defendant.

3. That the sum of $823.77, paid as a tax on account of payments to members of a class, and made up of forfeitures of others of the class, was legally assessed against the Plaintiff by the Commissioner of Internal Revenue, and legally and properly collected from the Plaintiff by the Defendant.

4. A mutual life insurance company, under G (b) of section 2 of the Act of October 3, 1913, had the right, in stating its gross income for any one year, to exclude the excess or redundancy in the premiums received by it for the particular year, but Congress did not intend that such a company should exclude from its statement of gross income for any one year sums which had been collected from policy holders prior to the year.

5. Under G (b) of section 2 of the Act of October 3, 1913, Congress did not intend that a mutual life insurance company should exclude from its statement of gross income for any particular
147 year, or that it should be allowed to deduct from its return of gross income for any particular year interest on dividends previously credited to policy holders.

6. Under G (b) of section 2 of the Act of October 3, 1913, Congress did not intend that a mutual life insurance company should exclude from its statement of gross income for any particular year,

or that it should be allowed to deduct from its return of gross income for any particular year, shares of forfeitures.

FRANCIS FISHER KANE,
United States Attorney.

And thereafter, to wit: on March 20, 1918, Hon. O. B. Dickinson filed the following answers to requests of plaintiff and defendant for findings of fact and law:

Answers to Requests for Findings of Fact and Conclusions of Law.

(Filed Mar. 20, 1918.)

DICKINSON, *J.:*

Plaintiff's Requests for Findings of Fact.

1. Requests 1, 2 and 4 are granted, and the facts found as therein stated.

2. Of the sub-requests under general request 3, all of them from 1 to 11, both inclusive, are granted, and the facts found as therein stated as descriptive of the business conducted by the plaintiff, and a statement in terms of dollars and cents of the volume of the business done and its apportionment. The special findings thus made, however, are subject to the general finding, and the ultimate fact found in the opinion already filed that the policy holder in every instance advanced to the plaintiff a sum of money estimated to be sufficient to cover the cost of insurance as it was subsequently found to have been and for the purpose of the payment of this actual cost, and further, that the return made to the policy holder was of the excess of insurance premium so paid.

148 *Plaintiff's Request for Conclusions of Law.*

Requests 1, 2 and 3 are granted and the findings made as therein requested, and judgment is entered in favor of the plaintiff and against the defendant for the sum of $6,865.03, with interest as stated.

Defendant's Request for Finding of Fact.

Defendant's request is denied, and the finding asked to be made is not made in the terms in which requested. The figures, however, as an expression of analysis of the transactions of the plaintiff company are found to be correct. The sums which were paid to policy holders was the return of part of the moneys which the policy holders had previously paid to the insurance company as and for premiums, the part of which returned not having been required to cover the cost of insurance but being the sum in which the amount paid by the policy holders exceeded the actual cost of the insurance.

Defendant's Requests for Conclusions of Law.

Requests 1, 2, 3, 4, 5, and 6 are denied as propositions of law applicable to the facts of the case. The fact having been found that the moneys returned to policy holders were parts of the moneys which the policy holders had advanced for premiums and which were found not to be required for the purpose of meeting the cost of the insurance, the plaintiff had the right to deduct the money so returned to policy holders from the sum of its gross income for the year in which the moneys were returned to the policy holders, notwithstanding the fact that the moneys so returned to the policy holders had been paid by them to the company previously to that year, and notwithstanding the further fact that the moneys received by the company had been at interest, and accretions came to
149 the company from other sources, thereby reducing the moneys which the policy holders were called upon to pay to the company to meet the actual cost of carrying the insurance.

And thereafter, to wit: on May 16, 1918, Hon. O. B. Dickinson allowed the following exceptions to the defendant:

Exceptions Allowed Defendant.

(Filed May 16, 1918.)

And now to wit: this 16th day of May, 1918, the following exceptions are allowed the defendant:

1. To the granting of Plaintiff's third request for finding of fact.

2. To the granting of Plaintiff's requests for conclusions of law.

3. To denial of Defendant's request for finding of fact.

4. To denial of Defendant's requests for conclusions of law.

5. To entry of judgment on April 26, 1918, in favor of Plaintiff, and against Defendant, in the sum of $8,398.21.

O. B. DICKINSON,
Judge U. S. Dist. Ct., E. D. of Pa.

And counsel for the said defendants did then and there tender this Bill of Exceptions to the action of the said Court, and requested that the seal of the Judge aforesaid should be put to the same, according to the form of the statute in such case made and provided. And thereupon the aforesaid Judge did put his seal to this Bill of Exceptions, pursuant to the statute in such case made and provided, this fourteenth day of June, A. D. 1918.

O. B. DICKINSON. [SEAL.]

Approved 6—14—18.
G. W. PEPPER,
By J. S. CONWELL,
Att'y for Pl'f.

150 *Judgment.*

Filed April 26, 1918.

Before Dickinson, J.

And now, to wit, this 26th day of April, 1918, in accordance with præcipe filed, judgment is hereby entered on the verdict in the above entitled case in favor of the plaintiff and against the defendant, in the sum of $8,398.21.

BY THE COURT.

Attest:
E. G. JOHNSON,
Deputy Clerk.

Petition for Writ of Error.

(Filed May 16, 1918.)

And now, this 16th day of May, A. D. 1918, comes the defendant herein and says that, on, to wit: April 26, 1918, this court entered judgment herein in favor of the plaintiff and against the defendant, in which judgment, and in proceedings had prior thereto, certain errors were committed, to the prejudice of this defendant, all of which will more in detail appear from the Assignment of Errors filed herein;

Wherefore, the defendant prays that a writ of error may be issued in this behalf to the United States Circuit Court of Appeals for the Third Circuit, for the correction of errors so complained of, and that a transcript of the record, proceedings, and papers in this case, duly authenticated, may be sent to the said Circuit Court of Appeals.

FRANCIS FISHER KANE,
United States Attorney.

Before Dickinson, J.

And now, to wit, this 16th day of May, 1918, the prayer for a writ of error is allowed.

BY THE COURT,

Attest:
GEORGE BRODBECK,
Clerk.

151 *Assignment of Errors.*

(Filed May 16, 1918.)

The defendant in this action, in connection with his petition for writ of error, makes the following assignment of errors, which he avers occurred on the trial of the cause, to wit:

1. The court erred in granting the third request of plaintiff for findings of fact, the said request being as follows:

"3. The said sum of $5,865.03 represents one per cent. (1%) upon the following items alleged by the defendant to be taxable but claimed by the plaintiff not to be taxable:

(1) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question provided in effect that after a certain number of premium payments the insurance should continue without any further payments by the insured, i. e., that the policy should become a full paid policy. Other contracts of insurance, written on the endowment form and outstanding during the tax period in question, provided in effect that the insured should be entitled to receive from the plaintiff a final share of surplus at the time of the receipt by him of payment of the sum insured. Still other contracts of insurance outstanding during said period provided in effect that upon payment of the sum insured as a death claim there should be paid also the final share of surplus to which the policy holder was entitled. In all these three cases the sums paid to the insured represented so much of the premium payments to the Plaintiff previously made by the insured as proved to be in excess of the cost of carrying the insurance. The aggregate of payments thus made by the Plaintiff during the last ten months of 1913 under policy contracts of these three types was $74,151.44.

152 (2) Certain of Plaintiff's contracts of insurance issued upon the Limited Payment Life Plan provided that, when all the premiums thereunder had been settled and the policies had thereupon become full paid should participate in future surplus of the company in accordance with their contribution. Such dividends are the outgrowth of redundant premiums paid in former years, and the product of such previous excess premium payments actually repaid by the plaintiff to policy holders in this group during the tax period in question was $14,846.69.

(3) Certain of plaintiff's contracts of insurance outstanding during the tax period in question provided in effect that annual dividends awarded to the insured should be retained by the company during five year periods under what are known as Five Year Option Policies. Such dividends are portions of premiums paid by the insured and subsequently proved to be in excess of the cost of carrying the insurance. These excess premium payments, while remaining in the hands of the company, earn interest, and the amount of interest thus earned by each policy holder's excess payment was included in the sum repaid to him. The total of these dividends paid during the last ten months of 1913 amounted to $51,944.95, and the interest accretions on this fund paid over to the policy holders whose premium payments had produced them was $14,257.01, a total of $66,201.96.

(4) Certain of the plaintiff's contracts of insurance outstanding during the tax period in question were issued upon what was known as the Life Rate Endowment plan, whereunder life premiums were

payable, the amount of the policy maturing in favor of the insured when the legal reserve under the contract, plus its accumulated dividends, equaled the face. It was also provided that such accumulated shares of surplus might be used to settle premiums or might be withdrawn in cash, in which cases the endow-
153 ment feature was deferred. Such dividends of surplus are portions of premiums theretofore paid which have proved to be redundant or excessive and which have been earning interest while in the hands of the company for the benefit of the insured. The aggregate of these dividends during the tax period mentioned was $38,374.18, and the interest payments yielded by them were $19,732.66, a total of $58,106.84.

(5) Certain of the plaintiff's contracts of insurance outstanding during the tax period in question were issued upon what was known as the Accelerative Endowment plan, the maturity of which was accelerated by the insured permitting his annual shares of surplus to remain in the custody of the company and to be increased by the addition of their own interest earnings. These were redundant portions of premiums theretofore paid. These repayments were made up of redundant premiums amounting to $8,289.28, together with interest earnings of $755.48, a total of $9,044.76.

(6) Certain of plaintiff's contracts of insurance outstanding during the tax period in question provided in effect that all dividends should remain with the company under a form of insurance known as Accumulated Surplus during selected periods, upon what has been known as the Semi-Tontine plan. In accordance with this plan policy holders who persisted in the payment of premiums and survived their respective accumulating periods participated in the accumulated dividends of the members of their respective classes who had meanwhile died or discontinued premium payments. These payments were made up of three elements; first, excessive premium payments made by policy holders of the class in question; second interest items earned by the excessive payments in the interval between their receipt by the company and repayment to the insured; third, the proportionate share of surplus, with its corresponding interest earnings, set free for the benefit of the persistent sur-
154 vivors by the death or lapse of some members in the class in question. The total of such dividends amounted to $195,870.77, their interest earnings were $76,068.59, and the sums set free by death or lapse as aforesaid were $58,112.08, a total of $330,051.44.

(7) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued as a modification of the Deferred Dividend plan, known as the six per cent bond, whereunder the dividends were accumulated in the hands of the company at interest. Such contracts contained a provision that should the insured die within twenty-five years there should be paid, in addition to the sum insured, an amount equal to six per cent thereof, or $60.00 per thousand, which was paid for by the insured at term rates. At the completion of the twenty-fifth year, in which case (in addition to the sum insured) there was a payment to the insured of the accumulated dividends with the interest which they had earned and

a share of the surplus with its interest accretions set free by death or lapse of the members of the class. The total of such dividends amounted to $12,340.87, their interest earnings were $10,353.98, and the sums set free by death or lapse as aforesaid were $9,816.27, a total of $32,511.12.

(8) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued as four per cent bonds, which provided in effect that at the maturity of the selected endowment period the insured could not permit the amount of his policy to remain with the company, subject to a four per cent interest addition, which could also be withdrawn at anniversaries. The total of such dividends amounted to $25,998.28, their interests earnings were $10,969.82, and the sums set free by death or lapse were $6,568.13, at total of $43,536.23.

(9) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued upon what was
155 known as the Guaranteed Dividend plan, which provided in effect that in the event of the death of the insured, before the termination of his accumulated surplus period, there should be paid by the Plaintiff a definite proportion of his total premium payments, which sum so paid represented the proceeds of term insurance upon the life of the insured and paid for by him at term rates. Should he survive the accumulated surplus period the insured was entitled to a repayment of his previous excess premium payments together with their interest earnings and his proportionate share of surplus and interest accretions set free by the death or lapse of other members of the class. The total of such dividends amounted to $20,945.63, their interest earnings were $10,912.14, and the sums set free by death or lapse were $7,880.19, a total of $39,737.96.

(10) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued as Trust Certificates, which provided in effect for an income to the beneficiary of a certain proportion of the sum insured, payable at fixed intervals during a stipulated period. Under policy contracts of this type the unpaid balance remaining in the hands of the company earns interest for the benefit of the beneficiary which is paid to him at the several periods of maturity specified in the policy, together with the instalment benefit payable to the beneficiary at such date. The amount of such interest earnings during the tax period mentioned was $15,540.59.

(11) Certain of the Plaintiff's contracts of insurance outstanding during the tax period in question were issued with what was known as an Interest Privilege, whereunder redundant premiums are retained by the company at a specified rate of interest, later withdrawable at the option of the insured. The total of such dividends
156 during the tax period mentioned was $2,644.15, and the interest earned thereon $130.20, a total of $2,774.35."

The answer of the court to the said request being as follows:

"2. Of the sub-requests under general request 3, all of them from 1 to 11, both inclusive, are granted, and the facts found as therein stated as descriptive of the business conducted by the plaintiff, and a statement in terms of dollars and cents of the volume of the business done and its opportionment. The special findings thus made, however, are subject to the general finding, and the ultimate fact found in the opinion already filed that the policy holders in every instance advanced to the plaintiff a sum of money estimated to be sufficient to cover the cost of insurance as it was subsequently found to have been and for the purpose of the payment of this actual cost, and further, that the return made to the policy holder was of the excess of insurance premium so paid."

2. The court erred in granting Plaintiff's requests for findings of law, the said requests being as follows:

"1. The amount of tax paid by the Plaintiff to the Defendant on June 29, 1914, was to the extent of $6,865.03, excessive and was unjustly and illegally assessed against the Plaintiff by the Commissioner of Internal Revenue, and was illegally and wrongfully collected from the Plaintiff by the Defendant.

"2. All interest items and all payments representing forfeitures or lapses included in the principal sum, of which $6,865.03 was the tax percentage, were sums other than dividends paid by the Plaintiff during the year on policy contracts within the meaning of section 12 of the Act of Congress approved September 8, 1916.

"3. The Plaintiff is entitled to recover the sum of $6,865.03, together with interest thereon from June 29, 1914, and judg-
157 ment is directed to be entered for this amount in favor of the Plaintiff and against the Defendant,"

the answer of the court to the said requests being as follows:

"Requests 1, 2 and 3 are granted and the findings made as therein requested ,and judgment is entered in favor of the plaintiff and against the defendant for the sum of $6,865.03, with interest as stated."

3. The court erred in denying Defendant's request for finding of fact, the said request being as follows:

"The amount $6,865.03, which the Plaintiff claims was illegally assessed and collected, was made up of $27.74, which the defendant admits was illegally assessed and collected; $4,427.62, tax on dividends accruing in previous years; $1,585.90, tax on interest on dividends; and $823.77, tax on forfeitures,"

the answer of the court to said request being as follows:

"Defendant's request is denied, and the finding asked to be made is not made in the terms in which requested. The figures, however, as an expression of an analysis of the transactions of the plaintiff company are found to be correct. The sums which were paid to

policy holders was the return of part of the moneys which the policy holders had previously paid to the insurance company as and for premiums, the part of which returned not having been required to cover the cost of insurance but being the sum in which the amount paid by the policy holders exceeded the actual cost of the insurance."

4. The court erred in denying Defendant's first request for conclusions of law, said request being as follows:

158 "1. That the sum of $4,427.62, paid as a tax on account of dividends accruing in previous years, was legally assessed against the plaintiff by the Commissioner of Internal Revenue, and legally and properly collected from the plaintiff by the defendant,"

the answer of the court to the said request being as follows:

"Requests 1, 2, 3, 4, 5 and 6 are denied as propositions of law applicable to the facts of the case. The fact having been found that the moneys returned to policy holders were parts of the moneys which the policy holders had advanced for premiums and which were found not to be required for the purpose of meeting the cost of the insurance, the plaintiff had the right to deduct the money so returned to policy holders from the sum of its gross income for the year in which the moneys were returned to the policy holders, notwithstanding the fact that the moneys so returned to the policy holders had been paid by them to the company previously to that year, and notwithstanding the further fact that the moneys received by the company had been at interest, and accretions came to the company from other sources, thereby reducing the moneys which the policy holders were called upon to pay to the company to meet the actual cost of carrying the insurance."

5. The court erred in denying Defendant's second request for conclusions of law, said request being as follows:

"2. That the sum of $1,585.90, paid as a tax on account of interest on dividends, was legally assessed against the Plaintiff by the Commissioner of Internal Revenue, and legally and properly collected from the plaintiff by the defendant,"

the answer of the court to the said request being as stated in
159 the Fourth Assignment of Error above set forth.

6. The court erred in denying Defendant's third request for conclusions of law, said request being as follows:

"3. That the sum of $823.77, paid as a tax on account of payments to members of a class, and made up for forfeitures of others of the class, was legally assessed against the plaintiff by the Commissioner of Internal Revenue, and legally and properly collected from the plaintiff by the defendant,"

the answer of the court to the said request being as stated in the Fourth Assignment of Error above set forth.

7. The court erred in denying Defendant's fourth request for conclusions of law, said request being as follows:

"4. A mutual life insurance company, under G (*b*) of section 2 of the Act of October 3, 1913, had the right, in stating its gross income for any one year, to exclude the excess or redundancy in the premiums received by it for the particular year, but Congress did not intend that such a company should exclude from its statement of gross income for any one year sums which had been collected from policy holders prior to the year,"

the answer of the court to the said request being as stated in the Fourth Assignment of Error above set forth.

8. The court erred in denying Defendant's fifth request for conclusions of law, said request being as follows:

"5. Under G (*b*) of section 2 of the Act of October 3, 1913, Congress did not intend that a mutual life insurance company
160 should exclude from its statement of gross income for any particular year, or that it should be allowed to deduct from its return of gross income for any particular year, interest on dividends previously credited to policy holders."

the answer of the court to the said request being as stated in the Fourth Assignment of Error above set forth.

9. The court erred in denying Defendant's sixth request for conclusions of law, said request being as follows:

"6. Under G (*b*) of Section 2 of the Act of October 3, 1913, Congress did not intend that a mutual life insurance company should exclude from its statement of gross income for any particular year, or that it should be allowed to deduct from its return of gross income for any particular year, shares of forfeitures,"

the answer of the court to the said request being as stated in the Fourth Assignment of Error above set forth.

10. The court erred in entering judgment on April 26, 1918, in favor of the Plaintiff and against the Defendant, in the sum of $8,398.21, whereas judgment should have been given for the defendant and against the plaintiff.

11. The court erred in finding in favor of the Plaintiff and against the Defendant.

FRANCIS FISHER KANE,
United States Attorney.

161 *Præcipe for Transcript of Record.*

(Filed May 16, 1918.)

SIR:

In making up the transcript of record sur writ of error in the above entitled cause, include the following papers and no others:

Docket Entries,
Writ of Error,
Statement of Claim,
Affidavit of Defense,
Stipulation as to trial without jury,
Stenographer's notes of testimony,
Plaintiff's Request for Findings of Fact,
Plaintiff's Requests for Findings of Law,
Defendant's Request for Conclusions of Law,
Defendant's Request for finding of fact,
Answer of Court to Requests for Findings of Fact and Conclusions of law,
Order of Court entering Judgment in favor of Plaintiff,
Stipulation as to Exhibits A, B and C,
Exhibit C, filed with Stipulation,
Exceptions,
Assignments of Error,
Petition for Writ of Error,
Clerk's Certificate,
Opinion of the Court.

FRANCIS FISHER KANE,
United States Attorney.

To the Clerk, U. S. D. C., E. D. of Pa.

162 UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, set:

I, George Brodbeck, Clerk of the District Court of the United States for the Eastern District of Pennsylvania, do hereby certify, that the annexed and foregoing is a true and faithful copy of so much of the pleas and proceedings in the case of The Penn Mutual Life Insurance Company, vs. Ephraim Lederer, Collector of Internal Revenue, No. 3724 June Term, 1915, as per præcipe filed, a copy of which is hereto attached, the transcript of record in the above entitled case is to include, and now remaining among the records of the said court in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said District Court at Philadelphia, this 12th day of July in the year of our Lord one thousand, nine hundred and eighteen and in the one hundred and forty-third year of the Independence of the United States.

GEORGE BRODBECK,
Clerk.

[SEAL.]

163 In the United States Circuit Court of Appeals for the Third Circuit, March Term, 1919.

No. 2399.

(List No. 4.)

EPHRAIM LEDERER, ETC., Plaintiff in Error,

v.

PENN MUTUAL LIFE INSURANCE COMPANY, Defendant in Error.

And afterwards, to wit, on the fourth day of March, 1919, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Hon. Victor B. Woolley, Circuit Judge, and the Hon. Thomas G. Haight and Hon. Hugh M. Morris, District Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the twenty-third day of May, 1919, come the parties aforesaid by their counsel aforesaid, and the Court now being fully advised in the premises, renders the following decision:

164 In the United States Circuit Court of Appeals for the Third Circuit, March Term, 1919.

No. 2399.

EPHRAIM LEDERER, Collector of Internal Revenue, Plaintiff in Error,

v.

THE PENN MUTUAL LIFE INSURANCE COMPANY, Defendant in Error.

In Error to the United States District Court for the Eastern District of Pennsylvania.

Before Woolley and Haight, Circuit Judges, and Morris, District Judge.

Opinion.

HAIGHT, *Circuit Judge:*

The defendant in error (the plaintiff below) sued to recover certain moneys which it claims were illegally assessed and exacted from it, by way of taxes for the year 1913, under the Income Tax Act of October 3, 1913 (38 Stat. L. 166). The case was tried without a jury, pursuant to sections 649 and 700 of the Revised Statutes, and resulted in a judgment in favor of the plaintiff for the full amount claimed. The questions presented depend for their decision upon

the construction to be given to certain of the provisions of Section II-G (*b*) of the before-mentioned act.

The plaintiff is a mutual life insurance company, without capital stock, conducting its business on what is known as the "level premium plan," and annually declares "dividends" to its policyholders. In order to relieve this opinion of the burden of a discussion of the method by which premiums are fixed under the level pre-
165 mium plan, and how and out of what funds the so-called "dividends" to policyholders are declared, we refer to the explanation on pages 202-203 of the opinion in Mutual Benefit Life Insurance Company v. Herold, 198 Fed. 199 (D. C. N. J.). That aptly describes the practice followed by the plaintiff in this case, except that a part of some of the dividends which enter into this controversy were derived from sources other than overpayment of premiums by the policyholders to whom such dividends were paid, as will be hereinafter set forth; but for present purposes the dividends in question may be considered as derived from and as representing the excess of the actual premium or premiums previously paid by a policyholder over the subsequently ascertained cost of his insurance for any given year or years. Such excess is included in the premium as a margin of profit and is in insurance parlance called, and will be frequently referred to, as a "redundancy." We deem it unnecessary to describe the different kinds of policies involved in this suit or how and when and why the dividends accumulated and were payable thereon, respectively; it being, we think, sufficient merely to point out that during the tax year of 1913 (from March 1 to December 31, 1913), the plaintiff paid cash dividends—moneys actually paid, as distinguished from dividends used in abatement of subsequent premiums or to purchase paid up additions to existing policies, etc.—aggregating in amount $683,729.03, to the holders of ten different kinds of its policies, and that in many cases no premiums were received or due from the same policyholders that year, and in other cases the premiums received from such policyholders were less than the dividends paid to them, respectively. The company claimed the right to exclude the aggregate of those payments from its total income during that period, in order to ascertain the net in-
166 come upon which, under the act in question, it was required to pay a tax. The Government, on the other hand, took the position that the whole of this sum could not be so excluded. Out of these contrary views the present controversy arose. The act imposed a normal tax "upon the entire net income arising or accruing from all sources" to every domestic insurance company. (Subdivision G (*a*) of Section II.) It also provided that the net income should be ascertained—

"by deducting from the gross amount of the income of such * * * insurance company, received within the year from all sources * * * the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts."

It then, after making special provisions in separate provisos for mutual fire insurance companies and mutual marine insurance companies, contained, in the latter proviso, the following:

"And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year."

The first of these clauses will, for convenience, be hereafter referred to as the "deduction" clause and the latter as the "non-inclusion" clause.

Leaving out of consideration for the moment, the grounds upon which the plaintiff contends that it is entitled to exclude those parts of the dividends paid to policyholders which do not represent the redundancies in the premiums previously paid by such policyholders, the plaintiff's before stated contention is based on the propo-
167 sition that under the "non-inclusion" clause, it may exclude from its total income (income derived from all sources) any moneys which it may have paid as dividends to policyholders during the tax year, provided that such payments represent redundancies in premiums previously paid by the same policyholders, irrespective of whether, during the tax year, it received anything by way of premium from them, respectively. The Government's contention proceeds on the theory that dividends paid to a policyholder or, for that matter, used in abatement of premiums or otherwise credited to a policyholder, may be excluded from the total income in any tax year only when the company has received a premium during the tax year from the individual policyholder to whom the dividend is paid, and then only to the extent of the amount of the premium so received, either actually or theoretically. These divergent views result from the different interpretations given to the words "portion of any actual premium." The company would read these words as characterizing the source from which the dividend was derived; that is to say, it would permit the exclusion from the total income of dividends paid or credited to policyholders when they represent redundancies in previous premium payments, without regard to whether any premiums were received that year from the policyholders to whom the dividends were paid. The Government, on the contrary, would read the words as limiting the extent or amount of the dividend paid or credited to the policyholder which may be excluded from total income, to the sum received by way of premium from that same policyholder during the year in which the dividend is paid or credited to him, without regard to the source from which the dividend was derived or when it became payable. It is also manifest that under the company's interpretation it is necessary that the
168 policyholders be treated as a whole, while under the Government's contention each is dealt with separately. Under the company's theory, if it received, for example, by way of premium, from all of its policyholders and from other sources, a total income in any given tax year, amounting to the sum of $1,000,000, and

paid to policyholders from whom it received no premium whatever that year, dividends amounting to $100,000 and which represented redundancies in premiums previously paid by those same policyholders, it would report as its gross income $900,000; whereas in fact its actual gross income was $1,000,000. The result, of course, would be to produce an erroneous net income, because the latter would be based on a false gross income. Under the Government's theory, the company would not be entitled to deduct any dividends paid to individual policyholders from whom it had not in that year received some premium or at least a premium equal to the amount sought to be excluded as paid to him; in other words, if A, a policyholder, in 1913 paid no premium but received a cash dividend representing redundancies in premiums paid by him in previous years, no account would be taken of the dividend paid to him in that year, so far as the company's taxable income is concerned. It would be left out of the calculation altogether. On the other hand, if the company in that year had received premiums from A, B, C, D, &c., and had paid to each of them dividends representing redundancies in premiums paid in a previous year or years, which as to each individual policyholder was less than, or did not exceed, the premium received from each, respectively, during the tax year, the company would be entitled, in ascertaining its gross income, to exclude the aggregate amount of the dividends so paid that year to those policyholders. The result would be that the amount thus reported
169 as gross income would represent the total of the amount actually received by way of premiums during the tax year.

The learned trial judge adopted the plaintiff's theory.

Having thus ascertained the contentions of the respective parties, the theories upon which they are based and the practical effect thereof, we now proceed to an analysis of the language of the statute, in the light of existing statutory enactments and judicial interpretation thereof at the time the act in question was passed. It will be noted, primarily, that the act, so far as life insurance companies are concerned, provides two distinct steps in the ascertainment of the taxable net income, viz., (*a*) the ascertainment of gross income; (*b*) the deductions to be made from gross income to ascertain net income. In ascertaining gross income it is specifically provided that certain parts of any actual premium received from any individual policyholder shall not be included; and after the gross income has thus been ascertained, the net income upon which the tax is to be assessed is arrived at by deducting various items, among which are the sums, other than dividends, paid within the year on policy and annuity contracts. This distinction was recognized by the company in making up its return for the tax year in question, because all of the moneys now in controversy were deducted from the company's total income for the purpose of ascertaining gross income and were not deducted from gross income for the purpose of ascertaining net income.

The original Corporation Excise Tax Act of 1909 (36 Stat. L. 112, C. 6, Sect. 38) which, so far as it imposed a tax upon the "entire net income," was, in all respects material to this case, the
170 same as the Act of 1913, authorized insurance companies to

make the same deductions from their gross income, to ascertain their net income, as does the "deduction" clause of the act in question; but it contained no such clause as the "non-inclusion" clause of the Act of 1913. For many years before the Act of 1909 was passed, it had been the policy of life insurance companies, both mutual and stock (when the latter issued participating policies) doing business on the level premium plan, annually to declare "dividends" to policyholders, which represented, as before mentioned, the difference between the premium provided in the policy to be paid and the actual cost of the insurance. The companies permitted the insured to use these dividends in any one of several ways, viz., as an abatement of future premiums; in purchasing paid up additions; withdrawal in cash, etc. When dividends were used in abatement of premiums, it was clear that the company actually, as distinguished from theoretically, received, in the year in which the abatement was made, not the full amount of the premium charged and payable under the policy, but only the difference between the dividend and the premium; and so in respect to full paid additions, while the company received the full premium due and chargeable under the policy, it did not actually receive the dividend as premium on the paid up addition to the policy. The result was that the companies sought, in making their tax returns under the Act of 1909, to charge themselves only with the moneys actually received in the tax year, and thus to eliminate from their gross income those dividends, which, as a matter of bookkeeping they appeared to have received that year but actually did not receive. The Government, on the other hand, contended that those dividends were such "dividends" as, under the act, the companies were not permitted to claim deduction for, and that they must
171 therefore be included as part of their gross income. The question thus presented first came up for judicial decision in Mutual Benefit Life Insurance Company v. Herold, supra, and in a well considered and reasoned opinion, the late Judge Cross adopted the contention of the insurance companies. His decision was affirmed by this Court on January 27, 1913 (Herold v. Mutual Benefit Life Ins. Co., 201 Fed. 918), and the Supreme Court later denied a certiorari to review it (231 U. S. 755). Thus by judicial construction one feature of the "non-inclusion" clause of the Act of 1913 had already been incorporated in the Act of 1909 when the later act was passed; i. e. that insurance companies were not required to include in their gross income such part of the premiums payable by policy holders as they had not actually received, but which had been pro tanto abated by the application of dividends. It is proper to here observe incidentally that dividends could not be used in abatement of a premium of a policyholder unless a premium was due from that policyholder, greater or at least equal in amount to the dividend.

On October 3, 1913, the act in question was passed, and in it the "non-inclusion" clause appeared for the first time. Reading the "non-inclusion" clause in the light of the before mentioned contentions and the history of the litigation thereon, and bearing in mind that so far as insurance companies are concerned, the deduc-

tions permitted to be made from gross income to ascertain net income were the same in the Act of 1909 as in the Act of 1913, it seems reasonable to conclude that the "non-inclusion" clause was inserted for the purpose of setting at rest, (which had not been authoritatively done when the act was passed, because the petition for the certiorari was not denied until December 15, 1913), the contention which the Government was making in these matters,

and to indicate clearly that it was not the intention of Con-
172 gress to assess a tax in any given year on such parts of premiums as the company received only in theory during that year, but exclusively on that part of the premiums which they actually received,—that which in fact—not in theory—came in to them. It will also be seen by reference to the decision of Judge Cross in the Mutual Benefit case (page 204) that where policy holders withdrew their dividends in cash the total amount of the premium payable under the policy was included in the plaintiff's statement of income received and the tax was imposed thereon by the Government; and the plaintiff in Conn. General Life Insurance Co. v. Eaton (218 Fed. 188, 203), appears to have done the same. It would therefore appear that when Congress used the words "paid back" in the non-inclusion clause of the Act of 1913, it made that act more liberal to the insurance companies, so far as "dividends" paid in cash were concerned, than the previous act had been construed even by the insurance companies. It took another step and treated a "cash dividend" just as the Courts had previously treated a dividend used as an abatement of a premium. It will be observed that the non-inclusion clause provides that life insurance companies "shall not include as income in any year." Congress did not say that life insurance companies might "deduct" from the total income in any year, etc. It used the words "shall not include." The word "include" carries with it the implication of something received, either actually or theoretically. It is difficult to understand how one may be relieved of including in his receipts something which he never received. How could an insurance company not include in gross income certain moneys paid out to policyholders if there were no premiums paid by those policyholders that year

from which to exclude them? Furthermore, Congress did
173 not say that a life insurance company should not include "such portions of any actual premiums received" etc., but it used the word "premium,"—the singular. To adopt the plaintiff's construction necessitates the reading of the word premium as premiums, in nearly every payment involved in this suit, unless it should be held that Congress intended to permit the deduction of such part or portion of only one previously paid premium as represented a redundancy in such premium. But no reason for such a limitation is conceivable. The words "that year" which the plaintiff contends must be read into the clause after the word "received," if the Government's construction is adopted, we think are there by implication, because of the use of the word "premium" instead of "premiums," and the words "shall not include." Furthermore the act directs that life insurance companies shall not include such portion of the premium received "from any individual policyholder"

as shall have been paid back or credited "to such individual policyholder or treated as an abatement of premium of such individual policyholder." It seems quite clear, by the use, thus conspicuously, of the words "individual policyholder," that Congress manifested an intention to treat each policyholder separately—his premium and his dividend—and not all of the policyholders as a whole,—the aggregate premiums and the aggregate dividends. In this connection it may be observed that the company keeps a separate account with each policyholder. If the purpose of inserting the "non-inclusion" clause in the Act of 1913 was as before stated, then it seems apparent that Congress used the language that it did, advisedly, for that language quite as explicitly expresses the thought that a life insurance company was to be taxed only on the income which it actually received, as distinguished from theoretically,
174 in any tax year, as it is inappropriate to convey the meaning which plaintiff seeks to gather from it. If Congress had intended that the aggregate of all dividends, representing redundancies in previous premium payments, paid to policyholders in a tax year should be deducted from the aggregate premiums received from all policyholders in that year, without regard to whether premiums were received that year from all of the policyholders to whom dividends were paid that year, it would not, we think, have used the words "shall not include" but rather the word "deduct;" nor the word "individual" qualifying the word "policyholder," and would have used the word "premiums" instead of "premium." The manifest reason why a difference is made in respect to dividends paid or credited to policyholders which do not exceed the premium received from the same policyholders during the tax year, and those which are in excess thereof, or in respect to those cases where no premium is received from the policyholder to whom a dividend is paid, and those cases where a premium is received, is that Congress desired to tax only the moneys actually received during the tax year and not those theoretically received, as the Government had been contending up to that time.

The plaintiff seeks to support its argument on the proposition that as the moneys paid back to policy-holders represent previous excess premium payments upon which, in fact or in theory, the company has theretofore paid a tax, that it is unreasonable, in the absence of clear and explicit language to that effect, to presume that Congress intended that they should be taxed again. But this argument loses sight of the fact that no tax whatever is levied on a dividend other than the initial one imposed when the premium of which it is a part is paid. No tax was imposed for 1913, for instance, on the
175 moneys paid back to policyholders as cash dividends in that year. The tax would be assessed only on such part of the moneys received by the company during that year as premiums from policyholders as was in excess of the dividends paid to the same policyholders that year. On the other hand, to permit the cash dividends, in excess of moneys received, either actually or theoretically, as premiums from the policyholders to whom they are paid,

to be deducted in 1913, would relieve the company from paying any tax whatever upon them; because by deducting them from gross income in that year it would nullify or neutralize to that extent the tax which had been imposed upon the premiums, of which they were a part, in previous years. It is thus apparent that what plaintiff really seeks to accomplish is not to avoid double taxation, but to be relieved from paying any tax whatever upon such parts of premiums, no matter when paid, as represent redundancies and which are subsequently returned to the policyholders who paid the premiums. It may be entirely equitable and just that Congress should have adopted such a course, but we do not think that we would be justified in finding such intention in a statute which expressly provides that the tax shall be levied "upon the entire net income arising or accruing from all sources," in the absence of a clear expression to that effect; and especially, when to do so would necessitate a strained and unnatural construction of the language used by Congress. Moreover, immediately preceding the clause in question are those dealing with mutual fire insurance companies, and mutual marine insurance companies. The provision in respect to the latter is as follows:

"Provided further, that Mutual Marine Insurance Companies shall include in their return of gross income gross premiums col-
176 lected and received by them less amounts paid for re-insurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof."

The language there used is quite different from that used in respect to life insurance companies, and the meaning to be gathered from it is clear. It specifically permits those companies to make the very deduction, as deductions, which the plaintiff claims that life insurance companies may make by way of noninclusion. The fact that there is such a marked difference in the language used in respect to the two kinds of companies, and each respectively conveys a different meaning, tends to strengthen the conclusion that so far as life insurance companies were concerned, they were, in ascertaining gross income, to exclude payments or credits to policyholders in the tax year, only to the extent of the amounts received, actually or theoretically, from the same policyholders, respectively, during the same year. The same deduction and noninclusion clauses were carried into the Income Tax Act of 1916 (39 Stat. L. 76), and later into the Act of 1919. The distinction between the two clauses is accentuated in the latter act, as they are placed in separate and distinct sections (Sect. 233 and Sect. 234). Section 233, which defines gross income, especially provides that in the case of life insurance companies "there shall not be included in gross income such portion" etc., using the same language as the Act of 1913; that mutual marine insurance companies must include in gross income the same items as the Act of 1913 required, but it makes no mention of what either kind of company may deduct. Section 234 deals with deductions exclusively, and permits the same deductions for life insurance com-

panies (par. 10) and for mutual marine insurance companies
177 (par. 12), as did the Act of 1913. It therefore appears that Congress has in each revision of the income tax law which it has made since 1913, retained the same language as respects both life insurance companies and mutual marine insurance companies as it did in the original act. It is a reasonable conclusion, therefore, that the language used in the Act of 1913 was advisedly used, and as it is different in respect to the two kinds of companies, that Congress intended that there should be a difference in the sums which each could, respectively, deduct on account of previous excess premium payments. That the construction for which we have indicated a preference is the correct one, is, we think, made more manifest when the action of Congress in using the same language in the Act of 1919, as it did in the Acts of 1913 and 1916, is considered in the light of the regulations issued by the Treasury Department under the Act of 1916 (Regulations No. 33 issued Jan. 2, 1918). Those regulations were as follows:

Premium Income Paid Back.—Life insurance companies are authorized to omit from gross income such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to the policyholder or treated as an abatement of his premium.

The amount authorized by this provision to be excluded from gross premium income on account of any premium refunded to any individual policyholder is explicitly limited to an amount not in excess of the actual premium paid by the individual policyholder within the tax year.

Cash Dividends.—Life insurance companies are entitled under the foregoing holding to exclude from gross income any part of the premium received which is paid back to the individual policy-
178 holder within the same return year. Where the dividend is in excess of the premium received, there can be excluded from gross income only the amount of the premium received from such individual policyholder within the same return year.

It must be presumed that Congress in passing the Act of 1919, had in mind the construction which the Treasury Department, in its regulations and instructions to Internal Revenue Collectors, had adopted, and that if such construction did not properly express the intention of Congress, a change in the language, to express clearly a contrary meaning, would have been made in the Act of 1919. Indeed, the Senate Committee which had the Act of 1919 in charge recommended a new basis for the taxation of life insurance companies, but in conference the Senate receded therefrom and the basis upon which life insurance companies had been therefore taxed was continued. (See Montgomery's Income Tax Procedure, 1919, p. 669.)

This situation is then presented: If the construction sought by the plaintiff is followed, although an equitable result would, in one aspect, be therefore accomplished, it would be done only by a strained construction of the statute, and one, indeed, which would not be in harmony with what we think Congress, by the language which it

used, manifested as its intention and confirmed by its subsequent action. If, on the other hand, the construction urged by the Government is adopted, a reasonable result is reached, which gives effect to what, it may be properly assumed, was the intention of Congress, namely, to tax as the income of life insurance companies in any year only so much of any premium as may have been actually received, as distinguished from theoretically, from any policyholder during that year. In this contingency, there is, of course, no
179 question as to which construction should be adopted. We conclude, therefore, that the plaintiff was not entitled to exclude from its total income during the tax year in question, for the purpose of ascertaining its gross income, any dividends paid or credited to policyholders from whom it did not receive any premium during that year; and as to such policyholders as it did receive premiums from that year, it was entitled to exclude only such part of the dividends paid to those policyholders as did not exceed the amount received from them respectively, by way of premiums, during that year.

Although plaintiff has not contended, except as to items of interest paid to policyholders (which feature of the case will be hereafter referred to), that it is entitled, in ascertaining its net taxable income to credit for the dividends paid to policyholders, on the theory that such dividends may be deducted, as distinguished from not included, under the "deduction" clause, we have, nevertheless, considered that question. It might readily be conceived that dividends paid to policyholders, representing as they do excess premiums, are paid "on policy * * * contracts." It may also be conceded that such dividends are not "dividends" in the commercial sense, as representing profits. Whether the word "dividends" is used in the "deduction" clause in the commercial sense or in the sense in which insurance companies ordinarily use it, we do not feel called upon to decide. If it be assumed, however, that the dividends in question are "sums * * * paid * * * on policy * * * contracts," and that they are not dividends in the commercial sense, and that the statute in the clause in question refers to only commercial dividends, it might be argued with force that insurance companies are entitled to deduct them, under the "deduction" clause, from gross income, to ascertain net income, were it not for the non-
180 inclusion clause. At the threshold of any such argument, however, we would be met with the fact that dividends paid or credited to policyholders are unquestionably covered by the "non-inclusion" clause. Manifestly, if it had been the intention of Congress that these dividends could have been deducted under the original "deduction" clause, there would have been no reason for adding the "non-inclusion" clause. Indeed, by the latter, Congress explicitly defined what moneys returned, either in cash or by credit, to policyholders might be excluded by the companies, in ascertaining their taxable net income. Consequently we do not think that any of the cash dividends paid by the plaintiff to its policyholders in the tax year in question, which represented redundancies in previous premium payments, were deductible as "sums other than dividends paid within the year on policy * * * contracts."

Up to this point we have dealt with only those parts of the cash dividends as represented redundancies in previous premiums paid by the same policyholder to whom the dividends were paid. It appears, however, that some of these dividends represent, in part, interest which had accumulated on dividends which had been left with the company under certain forms of policies; and, in part, also on some policies, the share of the policyholders to whom the dividends were paid in funds accruing to holders of the same kind of policies, which for one reason or another had been forfeited, and which, under the terms of the policies, were divided among those policyholders of the same class who had not thus forfeited such benefits. The company claims that it is entitled (although it did not follow that course in making its tax return) to deduct from its total income, to ascertain the taxable net income, such parts of the dividends as represent interest due to the policyholders, under the "deduction clause" of the statute, as payments made on policy contracts.

181 It also claims the right to exclude from its total income the parts which represent shares of forfeitures, upon the ground that the sums forfeited, and which are divided among the persisting policyholders, represent redundancies in the premiums paid by those policyholders who forfeited their right to the return of such redundancies. Hence, it is argued that under its construction of the words "portion of any actual premium," such sums are portions of actual premiums theretofore received, and deductible as such, irrespective of whether they originally came from the policyholder to whom the dividend is paid. Under the construction which we have given to the statute, as long as the dividends paid or credited to any individual policyholder within the tax year do not exceed the amount paid by way of premium by that policyholder during that year, it is quite immaterial from what source or sources the dividend paid or credited, arose. Hence, the independent question regarding the right to exclude such parts of the dividends as represent shares in the forfeitures of other policies is of no moment. However, as it is sought to procure credit, through the "deduction clause," for the parts which represent interest, it is necessary to ascertain whether such interest payments fall within that clause. Under all of the policies involved in this suit, with one exception, the rate of interest allowed to policyholders on redundancies which were left with the company and not withdrawn by the policyholder every year, was, in reality, dependent upon the earnings of the company upon its investments. Without attempting to decide, as before stated, because we find it unnecessary to do so, whether the word "dividend" is used in the deduction clause in its commercial sense, as distinguished from the insurance sense, we think that such interest payments are dividends in the commercial sense, as they clearly are in the

182 insurance sense. They represent the policyholders' pro rata share in the earnings on the company's investments, over a given period of time, and, as respects most of the policies involved in this suit, they are the result of compound interest. Hence they may not be deducted under the deduction clause. The one exception above referred to is the interest paid on what have been termed in the testimony "trust certificates." These moneys are not paid to

policyholders, but to the beneficiaries under instalment policies, which provide for the payment of the face of the policy, not in bulk on the death of the assured, but in instalments extending over a period of years. The fund thus left with the company, which, of course, diminishes from instalment period to instalment period, draws interest, and the interest is then paid to the person entitled to the instalments. It is accordingly, in neither an insurance nor a commercial sense, a dividend, but is a sum paid on a policy contract, and as such, we think deductible under the "deduction clause" of the act. It appears from the record that although all of the dividends in controversy were paid in cash to the policyholders, the company, during the tax year in question, received premiums that year from some of the policyholders to whom such dividend payments were made. The Government concedes the right of the company to recover the tax paid on such part of the dividends paid to policyholders during the tax year as does not exceed the premiums received that year from the same policyholders, respectively, as it does the tax on an item of $2774.35, which was inadvertently not included in the original return of the company. The actual amount which the Government concedes that the plaintiff is entitled to recover is, however, we think, excessive, because it includes the sums received from holders of "life rate endowment policies," which were considerably more than the sums paid to them, respectively,
183 during the year by way of dividends. Manifestly the company is only entitled in those cases to credit for the amount paid. As the aggregate amount received by way of premiums from policyholders of the policies in question during the tax year was much less than the amount paid to them by way of dividends, and as judgment was awarded in the court below for the tax assessed on the total amount of dividends paid, it follows that the judgment must be reversed and a new trial granted.

184 In the United States Circuit Court of Appeals for the Third Circuit, March Term, 1919.

No. 2399 (List No. 4).

EPHRAIM LEDERER, etc., Plaintiff in Error,

v.

PENN MUTUAL LIFE INSURANCE COMPANY, Defendant in Error.

In Error to the District Court of the United States for the Eastern District of Pennsylvania.

Order Reversing Judgment.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Eastern District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this

cause be, and the same is hereby reversed, with costs, and a new trial awarded. Philadelphia, May 23, 1919.

THOMAS G. HAIGHT,
Circuit Judge.

(Endorsements: No. 2399. Order Reversing Judgment, etc. Received and Filed, May 23, 1919. Saunders Lewis, Jr., Clerk.)

185 *Clerk's Certificate.*

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, set:

I, Saunders Lewis, Jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby Certify the foregoing to be a true and faithful copy of the original record and proceedings in this Court in the case of Ephraim Lederer, etc., Plaintiff in Error, v. Penn Mutual Life Ins. Co., Defendant in Error, on file, and now remaining among the records of the said Court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this twenty-second day of July in the year of our Lord one thousand nine hundred and nineteen and of the Independence of the United States the one hundred and forty-fourth.

[Seal United States Circuit Court of Appeals, Third Circuit.]

SAUNDERS LEWIS, JR.,
Clerk of the U. S. Circuit Court
of Appeals, Third Circuit.

186 UNITED STATES OF AMERICA, *ss:*

[Seal of the Supreme Court of the United States.]

The President of the United States of America to the Honorable the Judges of the United States Circuit Court of Appeals for the Third Circuit, Greeting:

Being informed that there is now pending before you a suit in which Ephraim Lederer, Collector of Internal Revenue, is plaintiff in error and The Penn Mutual Life Insurance Company is defendant in error, No. 2399, October Term, 1918, which suit was removed into the said Circuit Court of Appeals by virtue of a writ of error to the District Court of the United States for the Eastern District of Pennsylvania, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by
187 the said Circuit Court of Appeals and removed into the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the twenty-fourth day of October, in the year of our Lord one thousand nine hundred and nineteen.

JAMES D. MAHER,
Clerk of the Supreme Court of the United States.

[Endorsed:] File No. 27,254. Supreme Court of the United States, No. 499, October Term, 1919. The Penn Mutual Life Insurance Company vs. Ephraim Lederer, Collector of Internal Revenue. Writ of Certiorari. Received Oct. 29, 1919, Saunders Lewis, Jr., Clerk.

188 In the United States Circuit Court of Appeals for the Third Circuit, October Term, 1918.

No. 2399.

EPHRAIM LEDERER, Collector of Internal Revenue, Plaintiff in Error,
vs.
THE PENN MUTUAL LIFE INSURANCE COMPANY, Defendant in Error.

Stipulation and Agreement.

Whereas, a writ of certiorari directed to the Judges of the United States Circuit Court of Appeals for the Third Circuit was issued by the Supreme Court of the United States under date of October 24, 1919, commanding that the record and proceedings in the above entitled cause be sent without delay to the said Supreme Court so that the said Supreme Court may act thereon as of right and according to law ought to be done.

And whereas, a certified copy of the transcript of record and proceedings in the said cause is now on file in the office of the Clerk of the Supreme Court, the same having been procured and lodged there by The Penn Mutual Life Insurance Company, petitioner, in connection with its petition for a writ of certiorari, which petition was granted by the Supreme Court on the 20th day of October, 1919.

It is now and hereby stipulated and agreed that said certified copy of the transcript of the record and proceedings in the above entitled cause now on file in the Supreme Court may be taken as a return to said writ of certiorari with the same full force and effect as if an additional transcript of said record and proceedings were at this time certified to the Supreme Court.

FRANCIS FISHER KANE,
Attorney for Ephraim Lederer, Collector of Internal Revenue, Plaintiff in Error.
G. W. PEPPER,
Attorney for The Penn Mutual Life Insurance Company, Defendant in Error.

Endorsements: 2399. Stipulation of Counsel for Return to Writ of Certiorari. Received and Filed Nov. 10, 1919. Saunders Lewis, Jr., Clerk.

189 UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, Set:

I, Saunders Lewis, Jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby Certify the foregoing to be a true and faithful copy of the original stipulation of counsel for return to writ of certiorari in the case of: Ephraim Lederer, Collector of Internal Revenue, Plaintiff in Error, vs. The Penn Mutual Life Insurance Co., Defendant in Error, on file, and now remaining among the records of the said Court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Phlidalphia, this tenth day of November, in the year of our Lord one thousand nine hundred and nineteen, and of the Independence of the United States the one hundred and forty-fourth.

[Seal United States Circuit Court of Appeals, Third Circuit.]

SAUNDERS LEWIS, JR.,
Clerk of the U. S. Circuit Court
of Appeals, Third Circuit.

190 [Endorsed:] File No. 27,254. Supreme Court U. S., October Term, 1919. Term No. 499. The Penn Mutual Life Insurance Company, Petitioner, vs. Ephraim Lederer, Collector of Internal Revenue. Writ of certiorari and return. Filed Nov. 11, 1919.

IN THE

Supreme Court of the United States,

October Term, 1919. No. 499.

THE PENN MUTUAL LIFE INSURANCE COMPANY,

Petitioner,

v.

EPHRAIM LEDERER,

Respondent.

CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MOTION TO ADVANCE.

Now comes The Penn Mutual Life Insurance Company by George W. Pepper, its attorney, and moves the Court to advance the above-entitled case upon its docket in accordance with the provisions of rule 26 of the rules of this court.

Attorney for Petitioner.

STATEMENT OF CASE AND REASONS FOR MOTION.

1. The Penn Mutual Life Insurance Company brought an action in the United States District Court for the Eastern District of Pennsylvania against Ephraim Lederer, Collector of the Port. Suit was brought the third day of July, 1915, in conformity with the Act of Congress, relating to the recovery of taxes paid under protest.

2. The taxes in question were assessed and collected under the Income Tax Act of October 3, 1913 (38 Stat. L. 166), upon cash repayments made by a mutual life insurance company to its policyholders, by the amount of which repayments the company's net income for the tax year was in fact reduced. The company claimed the right to exclude such repayments from gross income, paid the tax assessed thereon under protest and brought suit to recover the amount so paid. The District Court entered judgment for the petitioner for the full amount of the claim. On writ of error to the Circuit Court of Appeals for the Third Circuit, the judgment was reversed and a new trial ordered. The mandate was stayed pending an application to this court for a writ of certiorari. The writ was granted, the record on appeal to stand as a return.

3. The question involved is such that the ends of justice require an early determination of the same for the following reasons:

(a) It involves the determination of the taxable income in 1913 and all subsequent years not only of the petitioner but of large numbers of mutual life insurance companies in the Third Circuit and elsewhere, by each of which payment of taxes under protest has been made to await the result of this proceeding.

(b) It involves the interpretation of the applicable language of the Revenue Bill now in force (Act of February 24, 1919, being Act 254 of the Sixty-fifth Congress).

(c) The determination of the pending question by this court is necessary to determine alike the rights of taxables under said statute and the practice of the Commissioner of Internal Revenue in making assessments and collections thereunder.

G. W. PEPPER,
Attorney for Petitioner.

HENRY, PEPPER, BODINE & STOKES,
Of Counsel.

IN THE

Supreme Court of the United States.

October Term, A. D. 1919.

THE PENN MUTUAL LIFE INSURANCE COMPANY,
Petitioner,
Defendant-in-Error,

v.

EPHRAIM LEDERER,
Respondent,
Plaintiff-in-Error.

On Petition for Writ of Certiorari directed to the United States Circuit Court of Appeals for the Third Circuit.

PETITION FOR WRIT OF CERTIORARI.

GEORGE WHARTON PEPPER,
Counsel for Petitioner.

International, 35 Clinton St., Philadelphia.

IN THE

Supreme Court of the United States

No. . October Term, 1919.

The Penn Mutual Life Insurance Company, Petitioner-Defendant in Error, v. *Ephraim Lederer,* Respondent-Plaintiff in Error.	On Petition.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Justices of said Court:

The petition of The Penn Mutual Life Insurance Company respectfully represents:

1. The petitioner, a mutual life insurance company incorporated under the laws of Pennsylvania, was the plaintiff in an action in the United States District Court for the Eastern District of Pennsylvania to recover taxes alleged to have been wrongfully assessed and collected by the respondent, who is the Collector of Internal Revenue for said district, and was the defendant in said action.

2. The taxes in question were assessed and collected under the Income Tax Act of October 3, 1913 (38 Stat. L. 166), upon an item of $683,729.03, composed of cash repayments during the tax year made by the insurance company to its policyholders, by the amount of which repayments the company's net in-

come for the tax year was in fact reduced. The sums so repaid represented in every instance, with certain interest additions, amounts previously paid to the company by the policyholders; which said amounts had been taxable by the Government in the year of their receipt, but were subsequently found to be in excess of the cost of insurance, were thereupon credited to the company's members and were, within the tax year, duly returned to them. The company claimed the right to exclude from the gross income of the tax year a sum equal to these repayments made within such year in virtue of the following provision of subdivision "6(a)" of Section II of said act:

> "And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;"

3. The District Court entered judgment for the petitioner (plaintiff) for the full amount of the claim. On writ of error to the Circuit Court of Appeals for the Third Circuit, the judgment was reversed and a new trial ordered.

4. The ground upon which the judgment of the Circuit Court of Appeals was based was in substance this: that the cash amounts in question, though representing excess premiums previously received by the company and previously taxed, were repaid by the company in a tax year subsequent to the year of receipt, and to policyholders who, in most cases, happened to pay no premiums to the company in the year of repayment; and that although an equitable result would, in one aspect, be accomplished by adopting the peti-

tioner's construction, yet the applicable provision of the statute should be construed as if the words here printed in brackets were a part of the section in question, although in fact they were not:

> "And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder [within such year] as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;"

5. Both of the two possible methods of arriving at net income are followed in the section in question: namely by making authorized deductions from an ascertained gross income and by making authorized exclusions from total income before gross income is ascertained. The process of returning excess premium payments to policyholders is the same in mutual marine and in mutual life companies and the entire proviso, quoted above in part, is as follows:

> "Provided further, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year;"

It is conceded that the result contended for by the petitioner must follow in the case of marine com-

panies; and the record of the proceedings in Congress when the act was under consideration clearly discloses an intention to treat marine and life companies alike; but the effect of the decision of the Circuit Court of Appeals is to discriminate between them in favor of the marine companies and to subject to taxation those items of repayment by which in common fairness the taxable income of life insurance companies should be reduced.

6. The question involved in the judgment under consideration is grave and of general importance for the following reasons:

(a) It involves the determination of the taxable income of the petitioner in years subsequent to 1913.

(b) It involves the determination of the taxable income in 1913 and subsequent years of large numbers of mutual life insurance companies in circuits other than the third, by which companies payment of taxes under protest has been made to await the result of this proceeding.

(c) It involves the interpretation of the applicable language of the Revenue Bill now in force (Act of February 24, 1919, being Act No. 254 of the Sixty-fifth Congress), which is as follows:

"In the case of life insurance companies there shall not be included in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year."

7. If the judgment of the Circuit Court of Appeals is suffered to stand, it will necessarily follow that the provision last above quoted from the Act of 1919 will be interpreted as if the words "within such taxable year" had actually been inserted by Congress after the words "received from any individual policy-

holder''; whereas, the petitioner shows to the Court that the Revenue Bill of 1919 as originally introduced into the House of Representatives contained in the section in question the following language:

> ''Such portion of any actual premium received from any individual policyholder *within the taxable year*;''

that the Senate amendment struck out this provision in pursuance of the Senate plan to tax insurance companies on the basis of investment income; that the House receded with an amendment restoring the original House provisions, but omitting the requirement in the case of a life insurance company that the premiums to be excluded from gross income must be received ''within the taxable year;'' all of which will more fully and at large appear upon reference to Conference Report No. 1037 of the Sixty-fifth Congress, dated February 6, 1919. If, therefore, the judgment of the Circuit Court of Appeals is to stand, an effect will be given to the present act which was sought to be attained by amendment but was distinctly repudiated by Congress in favor of the method of determining net income for which the petitioner contends.

8. Your petitioner is advised and believes that the aforesaid judgment of the United States Circuit Court of Appeals in said case is erroneous, and that this Honorable Court should require said case to be certified to it for its review and determination in conformity with the provisions of section 240 of the Judicial Code, said decree being made final in said Circuit Court of Appeals by the provisions of section 128 of the Judicial Code.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may be issued out of and under

the seal of this Court directed to the United States Circuit Court of Appeals for the Third Circuit, commanding the said Court to certify and send to this Court, on a day certain to be therein designated, a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals in the cause entitled:

"Ephraim Lederer, Collector of Internal Revenue,
Plaintiff in Error,

v.

The Penn Mutual Life Insurance Company,
Defendant in Error."

being No. 2399 of October Term, 1918, to the end that the said cause may be reviewed and determined by this Court as provided by section 240 of the Judicial Code, or that your petitioner may have such other or further relief in the premises as this Court may deem proper and in conformity with said provisions of the Judicial Code, and that the said judgment of the said Circuit Court of Appeals and every part thereof may be reversed by this Honorable Court.

THE PENN MUTUAL LIFE INSURANCE COMPANY,

By George Wharton Pepper,
Attorney for said Petitioner.

In the Supreme Court of the United States.

OCTOBER TERM, 1919.

THE PENN MUTUAL LIFE INSURANCE Company, petitioner,
v.
EPHRAIM LEDERER, COLLECTOR OF Internal Revenue.
} No. ——.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

STATEMENT.

Petitioner instituted suit to recover taxes claimed by it to have been, in effect, illegally collected under the income tax act of October 3, 1913 (38 Stat. 166). It obtained judgment in the trial court, but on writ of error the Circuit Court of Appeals in a carefully reasoned opinion reversed the lower court on the point here drawn in issue.

It is the contention of petitioner, concretely stated, that it is entitled under the statute which is set forth in its present petition, to withhold from *inclusion* in its income such sums as it pays back to policyholders from whom no premium is received during the taxing

134706—19

year. Its contention can not survive analysis, as so thoroughly demonstrated by the Circuit Court of Appeals in its opinion in this case.

1. Petitioner's view plainly violates the language employed in the proviso drawn in question, and which is set forth at page 3 of the present petition. It is to be observed that the proviso deals with two classes of insurance companies, viz, mutual marine insurance companies and life insurance companies, petitioner falling within the latter class. Furthermore, the proviso authorizes the marine companies to *deduct* amounts repaid to policyholders on account of premiums *previously* paid by them. Thus the language of the proviso so far as marine companies is concerned is specific in allowing credit for repayments made during the tax year on account of premiums previously received. Now in the same proviso, the latter portion thereof, when Congress came to deal with life companies, it did not repeat the language which it had employed with respect to marine companies, but framed the provision in language manifesting an intentionally different policy. With respect to life companies, they were not authorized to make "deductions" as were marine companies, but they were authorized to "*not include as income* in any year such portion of any *actual* premium received," etc. Here the proviso deals with the company's transactions with each individual policyholder. Not only so, but the proviso exempts from company income premium payments, which, but for the proviso,

would constitute income. Obviously this could not be so with respect to premiums not paid during the taxing year. To uphold petitioner's contention would require the insertion of the word "previously" between the words "premium received" in that part of the proviso dealing with life insurance companies here involved. That insertion would, of course, produce that equality in the treatment of marine and life companies for which petitioner contends, but certainly no rule of statutory construction would permit such insertion to be made. Congress saw fit to deal with marine and life companies on different bases, and if a seeming hardship is thereby worked upon life companies the remedy is with Congress, not the courts. Moreover, the very separation of marine and life companies in the proviso here drawn in issue demonstrates a manifest purpose on the part of Congress to accord them different treatment.

2. The proviso with respect to life companies is, in effect, an exemption gratuitously bestowed by Congress. In that aspect, it must be borne in mind that the burden rests upon petitioner to demonstrate that he is entitled to the exemption. (*Cliff* v. *United States*, 195 U. S. 159, 163; *United States* v. *Dickson*, 15 Pet. 141, 165.) The question here is not whether the amounts involved are income, but whether, under the bounty of the proviso, they need not be included in reported income.

3. The proviso here in question was repeated in the acts of September 8, 1916 (39 Stat. 756, 769, 770),

and February 24, 1919 (40 Stat. 1057, 1077). These later statutes represent legislative adoption of the executive interpretation of the act of 1913, and would now seemingly forbid an attempted different interpretation of the earlier act by the judiciary. *United States* v. *Hernanos y Compania* (209 U. S. 337, 339), and cases therein cited.

4. Petitioner's attempt to establish a different interpretation by reference to the legislative history of the act of 1919 is entitled to no consideration. As said in *Caminetti* v. *United States* (242 U. S. 470, 489, 490), in rejecting a congressional report, when "words are free from doubt they must be taken as the final expression of the legislative intent." The reasonable meaning of the proviso here involved, when read as a whole, is that attributed to it by the Circuit Court of Appeals.

5. For the foregoing reasons, it is respectfully submitted that the petition should be denied.

ROBERT P. STEWART,
Assistant Attorney General.

HARRY S. RIDGELY,
Attorney.

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SUBJECT INDEX.

	Page
Statement of the Case	1
Specification of Errors	4
Argument	8
1. Introductory Statement, Preceding an Analysis of the Revenue Act	8
The Statute in Question Obscure	8
Familiarity With Principles and Practice of Mutual Insurance an Aid to Interpretation,	9
The Taxable Element in an Insurance Premium,	10
Summary of Principles and Practice	11
The Three Problems Which Await Solution	14
2. Applicable Provisions of the Revenue Act of October 3, 1913	15
Gross Receipts, Statutory Gross Income and Net Income	16
The Cardinal Provision of the Statute	16
The Petitioner's Contention Conceded as to All Forms of Mutual Insurance, Except Life	18
The Processes of Non-Inclusion and Deduction,	19
The Question Is Whether the Refund to a Policyholder of a Prior Payment Should Reduce Taxable Income	23
How the Statute Should Have Read If Congress Seriously Meant to Tax Such Refunds	24
The Present Question Anticipated Before the Act Was Drafted	25
Improbable That Present Language Would Have Been Used If Government's Interpretation Intended	29

SUBJECT INDEX—Continued.

Page

3. Legislation Subsequent to the Act of 1913 30
Legislative Confirmation of Petitioner's Theory, 30
The Treasury Regulation of January 2, 1918, an Attempt to Prejudge a Then Pending Case, 31
The Revenue Act of February 24, 1919 32
The Amendment Supporting the Government's Theory 32
This Amendment Abandoned 33
If Judgment Affirmed Statute Will Be Construed as If Rejected Amendment Had Prevailed 36

4. The Income Tax Considered as a Tax on Income as a Whole 37
Erroneous Impression That the Tax Is a Tax on **Sources** 37
Brief Review of Decisions 38
The Tax an Excise Measured in Terms of Income 41
What Alone Constitutes the Income of a Mutual Company 42
The Magnitude of the Interests Here at Stake, 43

5. An Analysis of the Decision of the Court Below, 44
The Assumption That Exclusion or Inclusion Has Reference to the **Source** Instead of to Entire Income 45
The Court's Basic Illustration Fatal to What the Government Concedes 45
Qui Haeret in Litera, Haeret in Cortice 46
Mistaken Impression That Any True Income Item Escapes Taxation on Petitioner's Theory 46
Confusion Resulting From Processes of Non-Inclusion and Deduction 47

SUBJECT INDEX—Continued.

Page

Undue Weight Given to the Self-Serving Treasury Regulation 47

Failure to Consider the Great Question of Substance 48

6 Application of Principles to the Several Forms of Policy 48

Page

CASES REFERRED TO.

Brushaber v. Union Pacific R. R., 240 U. S. 19 41
Caminetti v. U. S., 242 U. S. 470 34
Flint v. Stone-Tracy Co., 220 U. S. 107 41
Connecticut General Life Ins. Co. v. Eaton, 218 F. 188 .. 27
Gould v. Gould, 245 U. S. 153 44
Herold v. Mutual Benefit Ins. Co., 201 F. 918 27
Mutual Benefit Life Ins. Co. v. Herold, 198 F. 199 26
Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601 .. 41
Southern Pacific Co. v. Lowe, 247 U. S. 334 38
Stratton's Independence v. Howbert, 231 U. S. 417 41

IN THE

Supreme Court of the United States.

October Term, 1919. No. 499.

THE PENN MUTUAL LIFE INSURANCE COMPANY,

Petitioner,

v.

EPHRAIM LEDERER,

Respondent.

CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

I. STATEMENT OF THE CASE.

The petitioner, a mutual life insurance company, incorporated under the laws of Pennsylvania, was the plaintiff in an action in the United States District Court for the Eastern District of Pennsylvania to recover taxes alleged to have been wrongfully assessed and collected by the respondent, who is the Collector of Internal Revenue for said district, and was the defendant in said action.

The taxes in question were assessed and collected under the Income Tax Act of October 3, 1913 (38 Stat. L. 166), upon an item of $686,503.38, composed of cash repayments during the tax year made by the insurance company to its policyholders, by the amount of which repayments the company's net income for the tax year was in fact reduced. The sums so repaid represented, in every instance, with certain interest additions, amounts previously paid to the company by policyholders; which said amounts had been taxed by the Government in the year of their receipt, but were subsequently found to be in excess of the cost of insurance, were thereupon credited to the company's members and were, within the tax year, duly returned to them. The company claimed the right to exclude from the gross income of the tax year a sum equal to these repayments made within such year in virtue of the following provision of sub-division G (a) of Section II of said act:

> "And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of

premium of such individual policyholder, within such year."

The District Court entered judgment for the petitioner (plaintiff) for the full amount of the claim. On writ of error to the Circuit Court of Appeals for the Third Circuit, the judgment was reversed and a new trial ordered.

The mandate was, however, stayed pending an application to this Court for a writ of certiorari. The writ was granted, the record on appeal to stand as a return.

The question at issue therefore is: What are the items which, under the act, a life insurance company is directed not to include as taxable income?

More specifically, the question is this: *Whether under the act the taxable income of a mutual life insurance company should not in all cases be reduced to the extent that portions of premiums have been refunded by it to policyholders during the year, the entire premiums having been included in taxable income of the company in the year of their receipt?*

The ground upon which the judgment of the Circuit Court of Appeals was based was in substance this (see R., p. 119): That the cash

amounts in question, though representing excess premiums previously received by the company and previously taxed, were repaid by the company in a tax year subsequent to the year of receipt, and to policyholders who, in most cases, happened to pay no premiums to the company in the year of repayment; and that although an equitable result would, in one aspect, be accomplished by adopting the petitioner's construction, yet the applicable provision of the statute should be construed as if the words here printed in brackets were a part of the section in question, although in fact they were not:

> "And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder [*within such year*] as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year."

II. SPECIFICATION OF THE ERRORS RELIED UPON.

It is respectfully submitted that the Court below erred in the following particulars:

1. In so construing G (a) of Section II of the Act of October 3, 1913, as to hold that

amounts equal to repayments of portions of premiums are to be excluded when calculating income only when premium payments were received within the same year as that in which the repayments are made.

2. In holding that amounts equal to repayments made to a policyholder are, under said act, to be excluded in calculating income only when during the tax year the company has happened to receive from the same policyholder a premium payment at least as large as the repayment.

3. In treating the income tax as being to such an extent a tax specifically assessed upon receipts from the individual policyholder that, in the absence of premium payments received from him during the tax year, repayments out of premiums previously paid by him and previously taxed cannot be excluded; whereas the tax is an excise tax measured by income from all sources regarded as a whole, with provision for an equitable exclusion from income of all items previously taxed and actually abated or repaid to policyholders within the tax year.

4. In failing to distinguish between, on the one hand, the blending of receipts for the purpose of ascertaining income for the tax

year, and on the other, the individualizing of transactions with particular policyholders for the purpose of making equitable exclusions of returned portions of premiums previously received from individual policyholders and previously taxed.

5. In holding that, unless the exclusion of repayments to policyholders is limited to the case of premiums received within the tax year, there is a failure to levy a tax "upon the entire net income arising or accruing from *all sources*"; whereas if the portion of a premium afterward refunded is really income at all, there is quite as notable a failure to tax it when the transaction is completed within the year as when the repayment is made in a subsequent year.

6. In holding that the items of interest which enter into the amounts repaid to policyholders are not properly deductable from income as "sums other than dividends paid within the year on policy contracts" within the meaning of G (a) of Section II of the Act of October 3, 1913, as re-enacted in Section 12 of the Act of September 8, 1916, and as substantially re-enacted in (10) of Section 234 of the Revenue Act of 1918, and in holding

that such interest payments "are dividends in the commercial sense as they clearly are in the insurance sense."

7. In deciding the questions at issue in accordance with the following statement:

> "If the construction sought by the plaintiff is followed, although an equitable result would, in one aspect, be thereby accomplished, it would be done only by a strained construction of the statute, and one indeed, which would not be in harmony with what we think Congress, by the language which it used, manifested as its intention and confirmed by its subsequent action. If, on the other hand, the construction urged by the Government is adopted, a reasonable result is reached, which gives effect to what, it may be properly assumed, was the intention of Congress, namely, to tax as the income of life insurance companies in any year only so much of any premium as may have been actually received, as distinguished from theoretically, from any policyholder during that year. In this contingency, there is, of course, no question as to which construction should be adopted. We conclude, therefore, that the plaintiff was not entitled to exclude from its total income during the tax year in question, for the purpose of ascertaining its gross income, any

dividends paid or credited to policyholders from whom it did not receive any premium during that year; and as to such policyholders as it did receive premiums from that year, it was entitled to exclude only such part of the dividends paid to those policyholders as did not exceed the amount received from them respectively, by way of premiums, during that year."

8. In reversing the judgment of the District Court instead of affirming said judgment.

III. ARGUMENT.

1. Introductory Statement, Preceding an Analysis of the Revenue Act.

The Court is here reminded of some of the fundamental principles of mutual insurance, because if these are forgotten it is easy to fall into the error of the learned Court below.

The statutory provision on which the controversy turns is so badly expressed that interpretation must amount almost to restatement.

To declare that:

"life insurance companies shall not include as income in any year such portion of any

> actual premium received . . . as shall have been paid back,"

comes perilously near to a declaration that what goes out shall not be included in what comes in.

Since, however, this remarkable language is used in the course of an effort to define the taxable income of mutual life insurance companies, the process of interpretation may be aided by a statement of how the business of such companies is actually conducted. The testimony of the petitioner's principal witness may be read with advantage. (R., p. 20.)

The ultimate source of all the income of any mutual insurance company is the premium payments made by the members.

The premium contains a number of elements. A part is applicable to the expenses of the business. A part is absorbed by losses. A part is required for reserves. A part is refunded to the policyholder.

Under some conditions a part may be retained by the company and added to the surplus which the company maintains in order to insure solvency. It may well be, however, that the conditions in any year are such that no addition whatever to surplus can be made, but on the contrary, the surplus is greatly re-

duced by excessive losses. This was the case in 1918 as a result of the extraordinary mortality resulting from influenza.

If a mutual insurance company is to be subjected to an excise tax at all, clearly the measure of the tax should be only such part of the receipts as is retained and added to surplus. To tax what goes out again to the members in payment of losses and refunds would be an unreasonable and even a confiscatory proceeding. Probably nobody would contend that sums paid to meet losses should be taxed; yet when rightly understood it is just as improper to tax overpayments refunded to policyholders. An effort on the part of the Treasury Department to do this latter thing has given rise to the present suit.

The effort is directed only at the mutual *life* insurance companies. As will presently be seen, the Revenue Acts deal with many other classes of mutual insurance companies. But it will be conceded that as to all these Congress has been careful not to exceed the limit of permissible taxation. The attempt is made so to interpret the obscure language of the section dealing with mutual life insurance companies as to single them out for discriminatory treatment.

The following is a statement of the way in which the repayment of redundant premiums to policyholders actually takes place in mutual life companies.

Mutual insurance is, of course, not conducted for profit. Insurance is and must necessarily be furnished to the policyholders at cost. Since it has been found impracticable to assess policyholders to meet losses after they have occurred, the premium payments must be calculated in advance (with an added factor of safety) and the amount of the payment actually found by subsequent experience to be excessive must be returned to the policyholder in some one or more of several different ways. If, for example, a premium charge of $100 is made against a policyholder at the beginning of a year and if the experience of the year shows that $90 would have been sufficient, the balance of $10 is returnable to the policyholder and in practice is actually returned to him. If in any tax year an entire transaction of this sort is completed, namely, the receipt of $100 by the company and the refund of $10 to the policyholder, it is reasonably clear that the income of the corporation for tax purposes ought to be regarded as $90 and not $100. That such is actually the result contemplated by the

Revenue Act is not disputed by the respondent.

At this point, however, it is necessary to take into account a complication resulting from actual practice but having no effect upon the principle involved.

The fact is that, as premium years are seldom if ever coincident with calendar years, it practically never happens that the transaction above outlined is completed within the limits of a calendar year. A policyholder makes his premium payment of $100 in one tax year and the return to him of so much of the payment as proves excessive is made in a subsequent calendar year.

In the calendar year in which his $100 payment is made the insurance company, of course, pays a tax on the full sum of $100 thus received. In the subsequent calendar year the insured may pay another premium of $100 and may receive a return from the company of the previous excess payment of $10, on which a tax to the Government has already been paid by the company, inasmuch as the item refunded is a portion of a premium previously received and previously taxed. The question will then arise whether the net income of the company for taxation purposes is $100 or only

$90 in such subsequent year. If the company is compelled to include in its income a sum equal to the $10 item which the policyholder gets back on account of his previous excessive payment, the result will be that the company will be compelled to pay a tax on what is really not an income item at all.

The respondent contends that this inequitable result is avoided only in the case in which the policyholder happens to be paying a premium in the year in which he receives his refund.

Under many forms of policy, after the obligation to pay premiums has terminated, the process of returning to policyholders their earlier excess premium payments still goes on. It may happen, for example, that the payment of $100 made in 1919 is the final payment under the policy, which thereafter stands as a full-paid policy. At the end of 1919 it may be discovered that the excess payment amounted, as before, to $10. In 1920, therefore, this portion of an actual premium received in 1919 from an individual policyholder, may be paid back or credited to him. When the company's taxable income for 1920 is being determined the question will in that event surely arise whether sums equal to all these repayments

made during the tax year ought not fairly to be excluded from the return of income, irrespective of whether in some cases the year of receipt and the year of refund are different.

If excess premium payments have been left with the company for several years and happen to exceed, in the year of their repayment to the policyholder, the whole amount of premium received from him in such year, the respondent contends that the act permits the exclusion from income of only that portion of the repayment which happens not to exceed the amount of the receipt.

From the foregoing summary statement it appears that three different situations may present themselves for consideration:

(1) A premium payment is received from an individual policyholder within the tax year and a repayment within such year out of a prior premium payment is made to him by the company of an amount not exceeding the new premium received. May the company exclude from taxable income a sum equal to the amount thus refunded to the policyholder on account of his previous overpayment?

(2) A repayment is made to a policyholder during the tax year of a portion of a premium

received prior to such year and taxed in the year of its receipt. It happens that the terms of the policy are such that no premium is payable by him to the company in said year and none is in fact paid. Is the company entitled to exclude from taxable income a sum equal to the repayment in question?

(3) A premium payment is received from a policyholder during the tax year and a repayment is made to him of a sum greater than the premium received. May the company exclude from taxable income a sum equal to the whole amount of the repayment or only such part thereof as is equal to the premium receipt?

The ultimate answer to all these three questions depends, of course, upon the language of the taxing statute, which will now be analyzed.

It will be noted, however, that the equitable considerations in favor of allowing the exclusion of the whole amount repaid are present with equal force in all three cases.

2. The Applicable Provisions of the Revenue Act of October 3, 1913.

The income tax imposed upon individuals by the earlier sections of the act is by Sub-

Section G (a) made applicable to corporate incomes. Sub-division (6) of Sub-Section G provides for the ascertainment of net income.

Inverting, perhaps, the normal process of thought the act first declares how statutory gross income is to be converted into net and later declares what exclusions are to be made from total receipts before arriving at gross.

It is provided, in the case of insurance companies, that net income is to be ascertained by deducting from statutory gross income "the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts."

Later in the sub-section appears the provision on the proper interpretation of which the result of this controversy depends.

The exact language of the statute is as follows:

> "*Provided further,* That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between

the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year."

The provision applicable to deductions will for convenience, be referred to as the deduction clause. The subsequent proviso will be referred to as the non-inclusion clause.

Under the Act of 1909 it was decided that the term "dividend" in the deduction clause meant a dividend in the commercial sense and not the refund of an overpayment with an interest accretion. Mutual Benefit Life Insurance Co. v. Herold, and Conn. Genl. Life Ins. Co. v. Eaton. These cases are discussed, infra, page 27.

Apparently Congress desired in the later act to cover all possible cases of repayment to policyholders. To the extent that such a repayment is part of an "actual premium," it is covered by the non-inclusion clause. To the extent that an interest-factor appears in it, the policyholder receives it in virtue of the

provisions of his policy and the item accordingly becomes a sum paid on a policy contract. It will be remembered that the company actually individualizes each policyholder by keeping a separate account with him. Everything repaid to him can be traced to his excessive premium payment with the added interest factor. And it must always be borne in mind that the interest received by the company upon its investments is year after year included in income and that every dollar of it is taxed.

When the non-inclusion clause is examined the first thing that strikes the reader's attention is that mutual marine insurance companies and mutual life insurance companies are grouped together in the same proviso. Attention is further arrested by the circumstance that in the case of marine companies the draftsman has expressed himself in terms of deduction and that in the case of the life companies he has used the non-inclusion form.

In the light of the statutory language with reference to marine companies, it cannot successfully be contended that marine companies may deduct only such amounts as were repaid to policyholders during the year of their receipt. There is not a word that can be tor-

tured into the semblance of such a limitation. Such companies may include in deductions in any year "amounts repaid to policyholders on account of premiums previously paid by them." In other words, the judgment appealed from in this case could not have been rendered had the petitioner been a mutual marine company.

That the legislative intention was to treat marine and life companies alike is suggested not merely by the fact that the equities in the two cases are the same, but by the comment of the managers on behalf of the House when the Act of 1913 had been in conference. Their explanatory report was, on this point, as follows:

> "Life insurance companies and mutual marine insurance companies are allowed exemptions to the extent of the actual premium overcharge returned or credited to policyholders." (Congressional Report, pp. 5769-5778.)

No inference of an intention to discriminate between marine and life companies can be drawn from the use of the language of *deduction* in the one case and of *non-inclusion* in the other. It will be observed that in both cases the terms are used with reference to the

gross income of the company and not with reference to premium payments received from policyholders. Marine companies may include the repayments in question "in deductions from gross income." That is, the deduction is not the deduction of a part from a larger premium payment made during the year, but is the deduction from the sum-total of income received during the year of a specific repayment made during such year. Life companies are directed not to include the repayments in question "as income in any year." That is, their receipts as a whole are to be diminished by the amount of specific repayments, and only the residue is to be regarded as the gross income of the company. The direction is not a direction to exclude from a premium received the portion thereof that is returned. Indeed, if the legislature had sought to attain the result contended for by the Government, it is probable that the language used would not have had reference either to deductions or to exclusions *from income,* but to *deductions from premiums received;* for, according to the Government, the exclusion is available only when the repayment is part of a premium received within the year; and if Congress had been dealing with this case alone, the natural

provision would have been a direction to deduct from a premium received the part thereof that was repaid.

If the question is asked why the language of deduction is used in the case of marine companies and the language of non-inclusion in the case of life insurance companies, the answer is that the draftsman evidently made no attempt to find a uniform formula for reaching the desired results; he took the data presented to him by those who were representing the point of view of the several classes of insurance companies and modified their form of expression no further than was necessary to produce a uniformity of result. This is made clear by a reference to the proviso which immediately precedes the proviso applicable to marine and life companies, i. e., the paragraph dealing with mutual fire insurance companies. The mutual fire company is directed not to return as income any portion of the premium deposit returned to the policyholder but is enjoined to return "as taxable income, all income received from all other sources plus such portions of the premium deposits as are retained by the company for purposes other than the payment of losses and expenses and reinsurance reserves." In other words, this

paragraph specifies the different parts into which a premium is sub-divided; namely, the part retained to meet losses, the part retained to meet expenses, the part (if any) applied to purchase reinsurance, the part returned to the policyholder, and the part retained by the company for any other purpose than the purposes specified, which part so retained is the only part which ultimately bears the burden of taxation. This obviously amounts to the same thing as to begin with a declaration that the whole premium is taxable and then to proceed with the deduction of all the elements in the premium except the taxable element; i. e., that portion of it which is to be retained by the company as an addition to surplus. It is also obvious that the same result could be attained by directing the company not to include as income such portion of the premium as is refunded or such portion as is used for any purpose other than by way of addition to surplus.

Having dealt with the case of mutual fire insurance companies in the way just described, the draftsman dealt with mutual marine companies exclusively by the method of deduction and then proceeded to deal with mutual life insurance companies by a com-

bination of the method of deduction and non-inclusion; for it is provided that the portion of a prior premium payment returned to the policyholder is not to be included in income and that the other non-taxable elements are to be placed beyond the reach of taxation by the process of deduction.

The point of it all is that the question presented by this record cannot be decided by merely taking account of the method employed by the draftsman to reach his end. Whether we proceed upon the deduction theory or the non-inclusion theory, or a combination of the two, we are still met by the question whether there is any good reason why the taxable income of any kind of mutual insurance company should not be diminished by the amount repaid to a policyholder during the tax year.

It would have been an easy matter to express with absolute clearness in any one of three ways the thought which the respondent attempts to inject into the language in fact used by Congress.

Thus the question in issue could not have arisen had the language of the statute read as follows:

"And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder *within such year* as shall have been paid back or credited to such individual policyholder or treated as an abatement of premium of such individual policyholder during said year."

Or, again, the issue under discussion would not have arisen had the legislature expressed itself thus:

"And life insurance companies shall be entitled to deduct from every premium received in any year such portion thereof as shall have been paid back or credited to the policyholder or treated as an abatement of his premium, and the amount so dealt with shall not be included as income in such year."

Or, finally, if there had been a desire to differentiate the similar cases of marine insurance and life insurance, the purpose could readily have been accomplished, as follows:

"Mutual marine insurance companies and life insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income

amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof, provided that no life insurance company shall deduct an amount repaid or otherwise credited to any policyholder in excess of the amount actually received from such policyholder during the tax year."

The foregoing suggestions are not without weight; because the question now presented had been raised prior to 1913, and the attention of the Collector of Internal Revenue and of the Congress had already been pointedly called to the subject of redundant premiums by litigation arising under the Corporate Excise Tax Act of August 5, 1909.

That act (c. 6, 36 Stat. 112, U. S. Comp. St. Supp. 1911, p. 946, §38) imposed an excise tax on an insurance company equivalent to 1 per cent. "upon the entire net income over and above $5000 received by it from all sources during such year." The section in question had further provided for the ascertainment of net income "by deducting from the gross amount of the income of such . . . insurance company received within the year from all sources . . . the sums other than dividends

paid within the year on policy and annuity contracts and the net addition, if any, required by law to be made within the year to reserve funds."

These provisions being upon the statute book, the question arose whether the excessive premium payment received in a previous year and so credited during the tax year as to reduce the amount of premium payable by the policyholder during each year, was to be regarded as part of the income of that year. In Mutual Benefit Life Insurance Company v. Herold, 198 Federal Rep. 199, 1912, it was contended by the Internal Revenue Collector that the company was to be regarded as having received the full premium specified in the policy and as having paid a dividend to the policyholder; that the transaction of receiving the entire premium was distinct from the transaction of paying the dividend and that as the statute forbade the deduction of "dividends" it followed that the company was taxable on the full amount of the premium. It was contended by the insurance company on the other hand that where the excess premium payment of a former year is applied at the policyholder's request to reduce proportionately the amount of premium paid by him dur-

ing the tax year, the amount thus refunded ought not to figure in taxable income, and that therefore the company was taxable only in respect to the difference between the premium specified in the policy and the amount of the so-called dividend. The District Court for the District of New Jersey decided in favor of the insurance company, and the Circuit Court of Appeals for the Third Circuit affirmed in Herold v. Mutual Benefit Life Insurance Co., 201 Fed. Rep. 918, 1913.

A conclusion in harmony with the decision in the Herold case was reached by the United States District Court in Connecticut, in Conn. Gen. Life Ins. Co. v. Eaton, 218 Fed. Rep. 188 (1914). In a learned opinion, Judge Thomas, in construing the deduction clause in the Act of 1909, held that the credit given to the policyholder out of the company's surplus was not a "dividend" within the meaning of the act, but represented nothing more than the excess of loading of the premium which was being returned in some form to the policyholder from whom it came.

Both the District Court and the Circuit Court of Appeals in the Herold case were clearly of opinion that the dividends which by the act the company was forbidden to deduct,

were dividends in the popular sense of the term; i. e., distributions of profit, and that the so-called dividends of a mutual insurance company doing business on the level premium plan did not fall within the provision of the statute because the item which they represented was not to be regarded as having been received during the tax year and not being included among the company's actual receipts gave rise to no problem of deduction. It will be perceived that the Court in the Herold case was not called upon to decide the question directly in issue here, namely, what is the status of premium refunds made in a tax year within the limits of which no premium has been received from the policyholder? The District Court nevertheless expressed an opinion, obiter, to the effect that the decision did not extend to the case of a full-paid participating policy wherein the policyholder has no further premium payments to make. See 198 Fed. Rep., at page 212.

In affirming the judgment of the District Court the Circuit Court of Appeals was careful to say:

> "But we do not adopt what is said on page 212 concerning dividends on full-paid participating policies, nor what is said on

the same page concerning stock companies, not because we wish to suggest disapproval, but merely because no opinion about these matters is called for now as they do not seem to be directly involved."

When, therefore, shortly after this significant statement was made by the Court, the Revenue Act of 1913 came to be drafted the draftsman must have been aware that one of the cases to be dealt with was the deduction from or non-inclusion in the gross income of mutual life insurance companies of dividends repaid during a tax year to policyholders who, during that year, were either making no premium payments at all or were making them to an amount smaller than the amount of the refund.

If the draftsman was impressed with the fairness of allowing the amount of all these dividend repayments to be excluded from income, irrespective of the accident of the date of the original premium payment, it seems entirely reasonable that he should have used the language which in fact appears in the Act of 1913. If, on the other hand, he desired to settle the then open question in the way for which the Government now contends, it is almost unthinkable that he should have used

the language which now appears in the act, and should not have adopted one of the three forms of expression above suggested.

3. Legislation Subsequent to the Act of 1913.

The conclusions drawn from a study of the Act of 1913 in the light of earlier legislation and judicial decisions are confirmed by a review of the applicable provisions of the revenue acts subsequently passed. The present action was begun in July, 1915, after the usual controversy with the Commissioner of Internal Revenue respecting a refund of the tax paid under protest. The interpretation of the Act of 1913 consistenly urged by the petitioner had been pressed upon the attention of the department. If Congress could have been persuaded to negative this interpretation in the Income Tax Act of 1916 it is safe to assume that the Treasury representatives would so have persuaded it. In point of fact, however, the language of the Act of 1913 was reenacted (on this point) without change. See Sub-division (6) of Sub-section 4 of Section 12 of the Act of September 8, 1916. That attention was directed at that time to the general subject of premium refunds appears from

the fact that the provision theretofore applicable to mutual fire companies were made applicable also to mutual employers' liability, mutual workmen's compensation and mutual casualty insurance companies. This shows the settled policy of the legislature to treat the taxable net income of mutual concerns as not including premium refunds. If mutual life insurance companies are not permitted to exclude these items they will be the only mutual concerns which are thus discriminated against, although life insurance is the form of thrift which should bear a lighter burden than any other.

In the opinion of the Court below (R., p. 119) a point is made of the treasury regulation issued by the department under the Act of 1916, which squarely rules the pending question against the contention of the petitioner. This ex parte pronouncement on a mooted question should have no weight with this Court. The trial of this case in the District Court took place on December 28, 1917. The special representative of the Internal Revenue Department attended and advised with the Federal District Attorney. (See R., p. 13). The trial Judge indicated very clearly his inclination against the contention of the

Government. Whereupon the Treasury representative returns to Washington and five days later, to wit, on January 2, 1918, out comes the treasury regulation in question. It was not a regulation ante litem motam. Under the circumstances of this case it has no more authority than the brief of counsel.

The Court is asked to give even more than usual attention to the legislative history of the War Revenue Law passed in February, 1919. It is submitted that this throws much light upon the interpretation of the provision under discussion.

When the War Revenue Act (of February 24, 1919, being Act No. 254 of the Sixty-fifth Congress) was originally introduced into the House of Representatives, it contained language unequivocally supporting the Treasury regulation above cited and the contention of the respondent in the present case. Section 233 (a) of the act was in these words:

> "In the case of life insurance companies there shall not be included in gross income such portion of any actual premium received from any individual policyholder *within the taxable year* as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year."

In other words, the draftsman did in fact use the first of the three forms of expression above suggested as natural forms of expression to use if it were intended to crystallize the contention of the Government into law.

The House having proposed this modification of the law, the Senate committee framed a measure which, if adopted, would have made a fundamental change in the taxation of insurance companies.

The Senate plan was to tax insurance companies on the basis of investment income. A conference ensued. What happened thereupon is stated in Conference Report No. 1037 of the Sixty-fifth Congress, dated February 6, 1919:

> "The House recedes with an amendment restoring the original House provisions, but omitting the requirement in the case of a life insurance company that the premiums to be excluded from gross income must be received 'within the taxable year.' "

The Senate receded from its proposal. The House withdrew the words which, if adopted, would have sustained the Government's theory, and the result was a substantial re-enactment of the language of the earlier acts which had at that time been construed by the District Court in the manner for which the peti-

tioner now contends. That the report of a committee of Congress may be referred to in aid of interpretation was recognized by this Court in Caminetti v. U. S., 242 U. S. 470 (1916), and in the cases cited therein.

The act thus framed (the Act of February, 1919, commonly called the Revenue Act of 1918) contains in Section 233 the following provision:

> "Sec. 233 (a) That in the case of a corporation subject to the tax imposed by Section 230 the term 'gross income' means the gross income as defined in Section 213, except that:
>
> (1) In the case of life insurance companies there shall not be included in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year.
>
> (2) Mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance."

Section 213, referred to in Section 233, throws no light upon the question in issue except that sub-division (2) of Sub-section (b) recognizes, by exempting them, the impropri-

ety of taxing *the policyholder* upon the amount represented by premium refunds, irrespective of the date at which the original payment was made.

If the question is asked why Section 233 omits all reference to the mutual companies other than life and marine which were dealt with in the earlier acts, and why there is likewise the omission of the non-inclusion or deduction clause in the case of marine companies, the answer is found in sub-divisions (12) and (13) of Sub-section (a) of Section 234, which are as follows:

> "(12) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, amount repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;
>
> (13) In the case of mutual insurance companies (other than mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10) inclusive (unless otherwise allowed under such paragraphs) the amount of premium

deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves."

A careful reading of all the foregoing provisions, in the Acts of 1913, 1916 and 1919, will, it is hoped, satisfy the Court that the following propositions are sound:

(1) That the taxable income of mutual insurance companies other than life is clearly to be reduced by the deduction or non-inclusion of premium refunds without reference to the date of the original premium payment.

(2) That if a different rule were to exist in the case of life insurance it would constitute an unreasonable exception to a general fiscal policy.

(3) That an attempt by the Treasury Department to engraft this exception upon the Act of 1919 was definitely repudiated by Congress.

(4) That if, therefore, the judgment of the Circuit Court of Appeals in this case is allowed to stand the same effect will be given to the present act as if the repudiated amendment had been adopted.

It is accordingly submitted that the method of determining taxable income contended for by the petitioner is vindicated both by the actual language of the Act of 1913 under which the question arises, and also by the subsequent course of events in Congress.

4. The Income Tax Considered as a Tax on Income as a Whole.

Underlying the entire contention of the respondent is the two-fold assumption that the non-inclusion of a premium refund is a non-inclusion in a specific premium payment rather than in statutory gross income, and that the act individualizes specific items of receipt instead of dealing with income as a whole.

The error in the former assumption has been indicated in the earlier part of this brief. A few words may be permissible in regard to the latter.

Sub-division (a) of Sub-section G of Section II of the Act of 1913 begins as follows:

> "That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every . . . insurance company."

In other words, the tax is on "the entire net income from all sources."

As already pointed out, this and the succeeding acts confessedly contemplate:

(a) *Actual gross receipts,* including (for example) an entire premium received during the tax year.

(b) *Statutory gross income* differing from gross receipts by the non-inclusion (for example) of so much of a premium received as is repaid within the year of its receipt.

(c) *Taxable net income* determined by deducting (for example) additions required by law to be made within the year to reserve funds and sums other than "dividends" paid within the year on policy and annuity contracts, said "dividends," or premium refunds, having been already dealt with by way of exclusion from gross income.

The attempt to confuse statutory gross income with the sum-total of actual receipts has been made many times by the Government and as often resisted by this Court. This is made clear by the following extract from the opinion of Mr. Justice Pitney in Southern Pacific Company v. Lowe, 247 U. S. at p. 334 (1917):

> "The purpose to refrain from taxing income that accrued prior to March 1, 1913,

and to exclude from consideration in making the computation any income that accrued in a preceding calendar year, is made plain by the provision last referred to; indeed, the Sixteenth Amendment, under which for the first time Congress was authorized to tax income from property without apportioning the tax among the States according to population, received the approval of the requisite number of States only in February, 1913. Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 581; 158 U. S. 601, 637; Brushaber v. Union Pacific R. R. Co., 240 U. S. 1, 16.

We must reject in this case, as we have rejected in cases arising under the Corporation Excise Tax Act of 1909 (Doyle v. Mitchell Brothers Co., ante, 179, and Hays v. Gauley Mountain Coal Co., ante, 189) the broad contention submitted in behalf of the Government that all receipts—everything that comes in—are income within the proper definition of the term 'gross income,' and that the entire proceeds of a conversion of capital assets, in whatever form and under whatever circumstances accomplished, should be treated as gross income. Certainly the term 'income' has no broader meaning in the 1913 act than in that of 1909 (see Stratton's Independence v. Howbert, 231 U. S. 399, 416, 417), and for the present purpose we assume there is no difference in its meanings as used in the two acts."

Gross income, under all the statutes, merely means the sum which in any given case would be taxable if there happened to be no deductions. While, therefore, it may not embrace by any means all that comes in, yet, when once ascertained, it is dealt with in its entirety. It is not conceived of as being the aggregate of net balances struck in numberless individual transactions. The exclusions are from receipts as a whole. The non-inclusions and the deductions have regard to gross income as a whole. To determine an item for non-inclusion or for deduction, it may be necessary to individualize a transaction. Thus it is essential to establish that a repayment to a policyholder in fact represents a portion of a premium previously received before the non-inclusion in gross income of a corresponding amount can be justified. But this is very different from saying, or thinking, that a payment must have been received from an individual policyholder within the year and must actually have figured in the receipts before the company can be permitted to omit from taxable income an amount equal to the portion repaid.

It is true that before the Sixteenth Amendment, this Court considered the specific

sources of the income which Congress had sought to tax in order to determine whether or not the tax was wholly or in part a tax on the properties which were the sources of some of the income and as such a direct tax and unconstitutional unless apportioned. Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601 (1894). But wherever it could properly be done, the Court, even before the amendment, recognized that the thing called "income" was to be considered apart from its source and was the measure of an excise tax rather than itself a subject of taxation. Flint v. Stone Tracy Co., 220 U. S. 107 (1910). In that case the Corporation Tax Act of 1909 was under consideration. "It was reasonable," said this Court in Stratton's Independence v. Howbert, 231 U. S., at page 417 (1913), "that Congress should fix upon gross income, without distinction as to source, as a convenient and sufficiently accurate index of the importance of the business transacted."

The Sixteenth Amendment disassociated income from its source and so dissolved the rule "by which alone such taxes were removed from the great class of excises, duties and imports." Brushaber v. Union Pac. R. R., 240 U. S., at page 19 (1915).

The Act of 1913, then, is an excise tax measured in terms of income. It is not a tax on premiums received by an insurance company within the tax year. It is not a tax on premiums received at any time. It is wholly immaterial whether payments from individual policyholders are or are not included in the income which in any given year is the measure of the tax. The only important question is: *How does the act define the measure?* The answer is that the statutory formula requires that all items of repayment to policyholders be omitted from the calculation, and, from the aggregate of items included, authorizes certain specific deductions. The resultant sum is the taxable net income of the corporation.

This view satisfies a reasonable expectation as to what should be the limit of taxation of a mutual life insurance company. All that comes in during the year, less what is absorbed by losses and expenses and reserves, and less amounts restored to the several mutual insurers out of their prior excessive deposits leaves an ample margin by which to measure an excise tax, as long as Congress chooses to persist in the policy of taxing this form of thrift.

After these elements are excluded from the

calculation there is left what is substantially an addition to surplus; and the sums thus carried into surplus come as near to being true income as anything can be in the case of a mutual company.

If it is objected that in a mutual company all of the accumulated surplus will ultimately be repaid to policyholders, and that, therefore, in the last analysis all taxation will be escaped, the answer is that no such result ensues while the company is a going concern; because in fact there is and always must be a large undistributed surplus to insure the company's solvency even under adverse conditions.

The Court will not fail to note that the relatively small amount of money involved in the present suit ($8398.21) is no index to the financial significance of the question involved. Quite apart from the fact that all other mutual life insurers will be affected by the decision, it is to be borne in mind that the question under review concerns the liability of the petitioner in the years 1914 and 1915 (during which the rate of tax remained 1 per cent.), in the year 1916 (during which the rate was raised to 2 per cent.), in the year 1917 (in which the rate was 6 per cent.), in the year 1918 (during which the rate was 12 per cent.),

and in the year 1919, during which the rate was 10 per cent. The amount involved in the decision, as affecting the policyholders in this company alone, is approximately $476,000.

To require the payment of an excise tax measured in part by sums returned to mutual insurers is to impute to Congress an intention to ignore the nature of mutual insurance and to impose a burden which ought not to rest upon such a form of activity unless the taxing statute clearly and manifestly discloses such an intention.

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions by implication beyond the clear import of the language used, or to enlarge their operations, so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government and in favor of the citizen." Gould v. Gould, 245 U. S., at p. 153 (1917).

5. An Analysis of the Decision of the Court Below.

The decision rendered by the learned Court below is to be explained upon the following grounds:

(1) The Court (R., p. 113) focused atten-

tion upon the fact that the item in dispute is by the act declared to be a "portion of any actual premium received" and tacitly assumed that the statute directs *the non-inclusion in the premium received* of the portion returned (see also R., pp. 116, 117, 118); whereas, in fact, it directs the *non-inclusion in income* in any year of the item in question. The Court overlooked the fact that the basis of the right to exclude is only two-fold: first, the fact that the item represents the redundant element in a previous payment; and second, the fact that the repayment is made within the year.

(2) The Court (R., p. 114) illustrated the petitioner's contention by assuming premium receipts in a given tax year of $1,000,000 and repayments of $100,000 to policyholders from whom no premium whatever was received in that year and observed that the company "would report as its gross income $900,000; *whereas in fact its actual gross income was $1,000,000.* The result of course would be to produce an erroneous net income, because the latter would be based on a false gross income." In making this statement and using it as a basis of inference, the Court ignored the distinction between actual gross re-

ceipts and statutory gross income; and failed to note that while an entire premium paid within the year is necessarily included in gross receipts, confessedly the portion of it refunded within the year is not included in statutory gross income. No good reason is suggested by the Court for regarding gross income as true in that case and false in this.

(3) The Court (R., p. 116) declared that "to adopt the plaintiff's construction necessitates the reading of the word premium as premiums in nearly every payment involved in this suit, unless it should be held that Congress intended to permit the deduction of such part or portion of *only one* previously paid premium as represented a redundancy in such premium." In so declaring, the Court overlooked the fact that for purposes of non-inclusion the act requires each specific repayment to be related to a previous actual premium receipt which is accordingly expressed in the singular; and that each repayment thus individualized is then excluded from statutory gross income by being charged against gross receipts.

(4) The Court (R., p. 117) reached the sound conclusion that no question of double

taxation is involved in this case, but drew from this the mistaken inference that the non-inclusion of premium overpayments made in former years causes items of taxable income to escape taxation. But confessedly Congress has directed the non-inclusion of such overpayments made within the year and the very question at issue is why any refunds should be treated as income when some are not.

(5) The Court (R., p. 118) conceded by implication that the petitioner's contention would be sound in the case of a mutual marine company, but was misled by the use of the processes of deduction and of non-inclusion into the belief that Congress meant to treat the two cases differently and repeated the two-fold error discernible throughout the judgment —first, that the exclusion is from a premium received, instead of from income as a whole, and, second, that the act taxes each item of receipt separately as distinguished from dealing with income as a whole.

(6) The Court (R., p. 119) gave weight to the Treasury regulation above referred to (p. 31) without realizing that it was a self-serving declaration by the Treasury Department made during the stress of this proceeding and failed to take account of the significant fact that an

amendment explicitly embodying the words which the respondent would read into the statute was definitely rejected by Congress when the Act of 1919 was enacted.

(7) The Court, in scrutinizing the letter of the statute, wholly failed to consider the substance of the matter in issue and appears to have overlooked the unreasonableness of imputing to Congress the intention to swell the taxable income of a mutual company by including in the measure thereof the amounts refunded to the mutual insurers.

6. Application of Principles to the Several Forms of Policy Involved in This Cause.

A summary of the items entering into the petitioner's claim will be found in a schedule in the Record (page 86), which is supplemented by an explanation at page 59. As to an item of $2774.35 to be added to the amount specified in the schedule, see the finding of fact on page 99.

The several forms of policy involved in this case are fully described in the testimony.

As to accumulated dividends used partly in abatement of subsequent premiums and partly withdrawn in cash, see Record pages 29-38.

For testimony as to "final dividends," see Record, pages 37-40; also findings of fact, page 96.

For testimony as to "full paid dividends," see pages 40-45; also findings of fact, page 96.

As to five year option policies see pages 45-47; and for findings of fact respecting these policies, page 97.

The testimony as to life-rate endowment policies will be found on pages 47-49, and the findings of fact on page 97.

Accelerative endowment contracts are explained on pages 49-50, and findings of fact on page 97.

Three types of policy (the Six Per Cent. Bond, the Four Per Cent. Investment Bond and the Guaranteed Dividend Contract) belong in the class of so-called deferred dividend or semi-tontine policies.

It is to be noted that the term "accumulated surplus" is applied to policies under which excess premium payments are left with the company to be pooled for the benefit of such policyholders included in the class as survive a specified date and, in the meantime, persist in their premium payments. If a policyholder included in the class dies before the arrival of the date in question, or suffers his policy to

lapse through failure to pay premiums, the accumulated overpayments which L would otherwise receive become available for pro rata distribution among the persistent survivors of his class.

For testimony as to the meaning of accumulated surplus and the characteristics of deferred dividend or semi-tontine policies, see Record, pages 50-52; and for findings of fact, see pages 97-98.

The testimony on the subject of the so-called deferred dividends may with advantage be supplemented by the following statement:

The estimated premium paid in advance on annual dividend policies and on deferred dividend policies is calculated on the basis of the same mortality table and rate of interest. A like loading is added in each case. The premium under an annual dividend policy is therefore exactly the same as the premium under a deferred dividend policy on the life of an insured of the same class and equal expectation of life. From this fact it necessarily follows that the yearly overpayments on each form of policy are the same.

When the amount of the overpayments made by the policyholders is ascertained at the end of each year, the company disposes of

them in one or the other of two ways for the benefit of its policyholders,—either (1) by equitably apportioning them among the policyholders and at once paying them back, or crediting them or treating them as an abatement of their several premiums; or (2) by crediting them to the policyholders as a class who paid them, accumulating them, and annually appropriating a sum out of this general credit and apportioning it among, and paying it as a dividend to, the members of the class whose policies call for a dividend that year. The first of these ways of disposing of these overpayments is commonly called the annual dividend plan; the second, the deferred dividend plan. The only difference between the two plans is in the way of accounting to the insured for their overpayments. On the annual dividend policies, the annually ascertained overpayments may either be paid back, or credited and paid back on demand, or treated as an abatement of premium each year; on the deferred dividend policies the annually ascertained overpayments can be credited only and then paid back on the dates stated in the policy in the manner above stated.

Thus, annual dividends result from the

overpayment of premiums; so do deferred dividends. Annual dividends belong to the insured and not to the company, because the insured are embarked in a mutual enterprise where each is entitled to his insurance at cost, and the dividend represents the difference between an estimated premium paid in advance, on the one hand, and cost, on the other, after cost has been ascertained at the end of each year. So also do deferred dividends. The annual overpayments on annual dividend policies may be paid back, or credited, or treated as an abatement of premium each year. The annual overpayments on deferred dividend policies must be credited. They are in fact credited annually, and a sum is annually appropriated out of the fund so held and is paid that year as a dividend to the members of the class whose policies call for a dividend that year.

It follows from the above considerations that the annual overpayment is no more the income of the company in the case of one form of policy than in the case of the other. In each case, the overpayment belongs to the insured, not to the company. It was the insured's money which, under the annual dividend policy, the company was bound either to

return, or to treat as an abatement of future premium, or to credit and return on demand; and, under the deferred dividend policy, was bound to credit only and to return at the end of the deferred dividend period to this very insured if he was then living and his policy in force; otherwise, by the agreement of the insured, to pay it to the survivors of his class whose policies were in force at the end of the period.

In each case it was the insured's money, not the company's, and was disposed of by the insured.

The Court will not forget that to the extent that interest items enter into these deferred dividends, the contention of the petitioner involves no loss to the Government because the company has paid an income tax on all the interest increment added to the overpayments returned to its deferred dividend policy-holders.

As the general contention of the petitioner in this case treats all mutual insurance companies alike, so that contention, as applied to annual dividend policies and deferred dividend policies, results in treating all mutual life insurance companies alike and avoids discriminatory treatment between holders of

different types of policy in the same company.

The construction placed upon the taxing statute by the Government discriminates not only against mutual life insurance companies as distinguished from all other mutual insurance companies, but also against those companies which have deferred dividend policies outstanding, and (within the limits of the same company) against those policyholders who have deferred dividend contracts.

The testimony as to the Six Per Cent. Bond will be found in the Record, pages 52-54; see findings of fact, page 98.

For testimony respecting the Four Per Cent. Investment Bond, see Record, pages 55-56, and for findings of fact, page 98.

The Guaranteed Dividend Contract is explained at pages 55-57, and is made the subject of findings of fact on page 98.

Upon the whole it is submitted that the statutory provision in question was correctly construed by the District Court and that the judgment of the Circuit Court of Appeals was erroneous. The exclusion from taxable income of items repaid to policyholders within the year of their receipt can be justified only

by the application of a principle equally applicable where the original payment was made in an earlier year. The attempt to read a time limit into the act is to impute to Congress an intention to ignore a fundamental principle. So to determine the taxable net income of a mutual life insurance company as to make the burden of the tax fall only upon the accumulated surplus is to carry out in the case of mutual life insurance the principle in fact applied by the revenue acts to all other forms of mutual insurance. To treat the overpayments refunded to policyholders as if they were dividends in a commercial sense is to ignore the findings of fact and to put upon the language of the statute an interpretation which it never was intended to bear.

It is respectfully submitted that the judgment appealed from should be reversed and the judgment of the learned District Court reinstated.

GEORGE WHARTON PEPPER,
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HENRY, PEPPER, BODINE & STOKES,
Of Counsel.

In the Supreme Court of the United States.

OCTOBER TERM, 1919.

THE PENN MUTUAL LIFE INSURANCE Company, Petitioner, *v.* EPHRAIM LEDERER, RESPONDENT. } No. 499.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

This is a suit commenced in the District Court by a mutual life insurance company to recover a part of the income taxes paid by it, under protest, for the period beginning March 1, 1913, and ending December 31 of the same year. The taxes were assessed under the revenue act of 1913 (38 Stat., c. 16, 166, 172), and amounted to $18,247.82. The company admitted liability for $11,382.79, and sued to recover the remainder, or $6,865.03. The District Court, trying the case without a jury, rendered a judgment for the amount claimed. (Rec., p. 96.) The Circuit Court of Appeals has reversed this judgment. (Rec., p. 122.)

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THE STATUTE.

The act of 1913 became effective March 1, 1913, and imposed upon the net incomes of individuals a normal tax of 1 per cent annually. Section 2, subsection G (a), imposed the same normal tax upon "entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company," etc.

The general scheme of the tax is that it shall be imposed upon the net profits of the year's business. In order to arrive at this it is provided that from the gross income derived from all sources there shall be deducted certain items covering generally the expenses of conducting the business and the losses incident thereto. The remainder represents practically the net profit, or the sum which a corporation may, if it chooses, distribute among its stockholders. It is the net income upon which the tax is imposed. The deductions thus to be made from the gross income are carefully enumerated. Certain of them apply alike to all corporations. The business of insurance companies, however, is so different from that of other business corporations that some special provisions were deemed necessary. Hence, in section 2, G (b), to the clause allowing a deduction for ordinary and necessary expenses, there is added this:

> * * * and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: * * *

It was also recognized that there are material differences between the business of an insurance company which has a capital stock and one which is purely mutual, and it was deemed necessary to make special provision in the case of mutual companies. Good reasons also appeared to Congress for drawing some distinctions between different kinds of mutual insurance companies. So, while the provision just quoted, allowing a deduction for all sums, except dividends, paid within the year on policy and annuity contracts, applies alike to all insurance companies, Congress proceeded to make a separate provision applicable to each of three kinds of mutual insurance companies. The first was:

> That mutual *fire* insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves.

The second was:

> That mutual *marine* insurance companies shall include in their return of gross income premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on

> account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof * * *.

And the third was:

> * * * life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year.

It will thus be seen that in the case of all insurance companies no *deductions* were to be made from gross income on account of *dividends* paid on policy and annuity contracts, except in the case of mutual marine insurance companies, as indicated below. The special provision applying to mutual fire insurance companies dealt alone with what should be deemed *income derived from premiums* and had no reference to *deductions* from whatever was thus determined to be the gross income. In the case of mutual marine insurance companies there was a specific provision that the gross amount of premiums collected or received should be included in gross income, but there was coupled with it a provision that from the gross income thus ascertained a deduction should be allowed of all amounts repaid to policyholders on account of premiums previously paid by them,

and interest thereon. The special provision relating to life insurance companies again makes no reference to *deductions* from gross income, but deals alone with what shall be included in gross income as income derived from premiums. The provision, in substance, is that the amount to be included as received from each individual policyholder shall be not necessarily the full amount of the premium, but the amount actually paid by such policyholder after using, for the payment or reduction of his premium, any amount that may have been due him as a dividend on account of premiums previously paid.

THE FACTS.

The petitioner is a mutual life insurance company doing business on what is known as the level-premium basis—that is, each policyholder pays annually a fixed premium. In determining what this premium shall be, the company takes into consideration the experience of insurance companies in general, as evidenced by recognized mortality tables. It also takes into consideration that premiums as received are invested and income in the way of interest is derived from them. In addition, it includes an estimate of the cost of doing business. Since the company has no capital, its rates, for the purpose of safety must be made high enough to cover all contingencies. The result is that it purposely estimates that a sum somewhat larger than indicated by the mortality tables will be required; that the rate of interest

which it will realize on its invested funds will be somewhat less than it actually expects; and that the expenses of conducting the business will be somewhat more than is really anticipated. Naturally, then, at the end of the year it usually happens that it has not been necessary to use the entire amount of the premiums paid. Being a mutual company, the policyholder is entitled to receive, in some form, the benefit of this excess payment. He has several options. He may receive it in cash; he may have it treated as an abatement of his premium for the next year; or he may leave it with the company to accumulate for his benefit, and continue to pay the full amount of his premium each year.

The petitioner issues a number of different forms of policies. Some provide for the annual distribution among policyholders of these excess payments. Others provide for a distribution only after a period of years; and still others provide for the distribution at the maturity of the policy, or, in some cases, for the credits thus due the policyholder to be used to accelerate the maturity of his policy. Under many of these policies a given number of premiums are to be paid and then the policy is paid up. In these cases the excess amount of premium collected the last year becomes a dividend payable in the succeeding year, in which year, however, the policyholder pays no premium. This applies to several different forms of policies.

The assessment under which the taxes in controversy were paid was made for the year 1913. The

petitioner was required to report, as gross income, the amount of cash actually received, in payment of premiums, from each individual policyholder. If a policyholder did not use his dividends for the purpose of paying or reducing his premium, but paid the whole amount in cash, that amount was included in gross income; but whenever a policyholder used, in reduction of his premium for 1913, the dividend or amount due him on account of premiums previously paid, and only paid the balance in cash, only the latter amount was included in gross income. In this way the item of gross income derived from the payment of premiums was the total amount of premiums received from policyholders less the total amount of dividends which had been used in paying or reducing premiums. If the dividend was larger in a particular case than the premium, no premium was included in the gross income returned.

During the period in question, however, the company paid, in cash, dividends to the amount of $686,503.38. No part of these dividends were used in any way in the payment of premiums falling due in 1913. The present claim of the company is that, in some way, this amount should be deducted from the amount of income which it actually received in cash during 1913.

THE CONTENTION OF PETITIONER.

In the petitioner's statement of claim filed in the District Court its case was stated thus:

> The amount upon which the said assessment for the year 1913 was made up included the

> item of tax assessed upon portions of actual premiums received from individual policyholders and paid back to such individual policyholders in cash between March 1 and December 31, 1913, the sum of $686,503.38. The said item was improperly and illegally, and without warrant in law, included by the said Commissioner of Internal Revenue in the amount upon which said assessment for the year 1913 was made. One per cent of the said sum so improperly and illegally included amounts to $6,865.03. (Rec., p. 5.)

This statement, however, is inaccurate and misleading. Not a dollar of the amount stated was received by the company between March 1 and December 31, 1913, as premiums. All of it represented sums which had become due to policyholders, as dividends, on account of excess premiums paid prior to March 1, 1913. So far as the taxable period for which the assessment was made is concerned, these sums were not income received by the company, but were disbursements made by it. Not a dollar of them was included in the gross income returned for the period in question. That gross income was made up exclusively of the cash actually received by the company during that period. It can not be said, therefore, that these sums were included in the gross income. The real complaint, at last, is that they were not deducted from the gross income in order to arrive at the net income.

It is obvious that in the statement quoted above the petitioner undertook to follow the language of

the statute. But when its counsel came, in the brief, to state accurately and exactly what its claim was, the impossibility of bringing it within the terms of the statute is obvious. The statement at page 2 of the brief is:

> The company claimed the right to exclude from the gross income of the tax year a sum equal to these repayments made within such year in virtue of the following provision * * *.

Thus, what is claimed is not that anything was improperly included in gross income, but that, the gross income, having been ascertained, there should have been excluded from it not something that had already been included, *but a sum equal to certain repayments which the company had made.*

CONTENTIONS OF THE RESPONDENT.

The respondent contends that (1) the provision of the revenue act applying to mutual life insurance companies merely excludes from gross income *a certain portion of each premium* collected during the tax year; that the portion thus excluded is the amount due the policyholder on account of the payment of previous premiums and which is used in payment or reduction of his premium falling due in the tax year; and that hence the provision in question can have no possible application to a *dividend* paid by the company to a policyholder who pays no premium during the taxable year; and (2) that the dividends thus paid by the company are, by the terms of the

act, excluded from the deductions from gross income that may be made on account of payments made on policies.

BRIEF.

I.

An insurance company is not entitled to deduct from its gross income dividends paid either to stockholders or policyholders.

As shown above, the statute, in general, allows a deduction for sums paid on policy and annuity contracts during the tax year. There is, however, one express exception to this—the sums so paid and deducted must be "other than dividends." If, therefore, the payments made by the petitioner to its policyholders during the year 1913 were dividends, it is manifestly not entitled to deduct the amount of these payments from whatever is ascertained to be the gross income.

In the case of an insurance company with a capital stock, premiums are fixed at rates which are estimated to be sufficient to pay the expenses of the business, pay the amounts coming due on policies, maintain the reserves required by law, and yield a fair return on the capital of the company. When, therefore, in a particular year all of these items, except the last, are provided for, what is left is substantially the net profits of the business and the amount which the company is at liberty to distribute as dividends among its stockholders. In the case of a mutual company,

however, the business is conducted solely for the benefit of the policyholders. It collects premiums at fixed rates, which are usually somewhat in excess of what proves to be necessary to meet the requirements of the business for the year. Whatever is saved from the amount of premiums thus paid represents the net profits to the policyholders and is subject to distribution among them, just as it would be subject to distribution among stockholders in the case of a stock company.

In either case, after all deductions are made from gross income, this saving represents, at last, substantially the net income of the company which is taxable. It is a net income which the corporation has received, in the case of a stock company, for the benefit of its stockholders, and sometimes for the benefit of both its stockholders and its policyholders, and in the case of a mutual company for the benefit alone of its policyholders. It is the only kind of a dividend which a mutual insurance company can declare, or which any insurance company can pay on account of its policies. There is, therefore, nothing else to which the word "dividend," as used in the statute, can be applied. When, therefore, it was expressly provided that dividends paid by insurance companies on account of policies should not be deducted from gross income, no possible ground was left upon which to claim a *deduction* on account of the payments made by the petitioner to its policyholders in 1913. True, these payments were in effect, a return of overpayments which had been

made in previous years. But, as said in *Fuller* v. *Metropolitan Life Insurance Co.*, 70 Conn. 647, 665:

> Such return of overpayments, whether in cash, or by application on future premiums, or by increase of the amount insured, is a dividend. This is the meaning of "dividend," and the only meaning it has or can have in connection with mutual insurance.

Indeed, it is not apprehended that it will be seriously contended that the petitioner is entitled to the relief it seeks under the provision of the statute allowing *deductions* from gross income.

II.

The petitioner was required to return, as gross income received from premiums, only the actual cash so received after excluding that portion of each premium which was paid by the application of dividends due the policyholder on account of overpayments made in previous years. This is in exact accordance with the statute.

Since petitioner can get no relief under the clause providing for *deductions* from gross income, it turns to the proviso dealing with what shall be *included* in gross income. The gross income from premiums, as returned, is exactly the amount of cash which has during the year been paid to the company on that account. There has been excluded from it every part of a premium which was paid by using the dividend or credit to which the policyholder was entitled on account of previous payments of premiums. To illustrate: If a premium was $100 and the policyholder

used a dividend of $10 and paid $90 in cash, only the latter sum has gone into the gross income returned by the petitioner. Applying the statute to the year 1913, for instance, it is provided that in determining the gross income for that year the company "shall not include such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year."

Manifestly, this provision *not to include* does not refer to anything except premiums received during the year for which the return is being made. It, of course, refers to something which would otherwise be included as income. Premiums are the chief source of income of any insurance company. Without some provision to the contrary the full amount of every premium received during a particular year would obviously be a part of the income for that year. If, however, a particular policyholder has paid more in a previous year than was necessary to carry his insurance, and the sum of $10, for instance, is due him from the company on that account, it may very well be said that he has already paid that much of his next premium. If he pays no more than the difference between his premium and this amount in the succeeding year, the company has, in fact, received from him no more than the amount so paid. The full amount of a premium paid in one year becomes a part of the taxable income of the company for that year.

If the payment includes enough to pay a part of the premium for the next year, then all that goes into the company's taxable income for the latter year is the remainder of the premium which is paid in that year.

The proviso in the statute deals, as we have seen, alone with what shall be included as income. The act of paying a dividend by an insurance company is in no sense a receiving of income by it. On the contrary, it is a disbursement. Proper disbursements, when allowed by the statute, are deducted from gross income in order to ascertain the taxable net income. But disbursements can never, in any sense, be regarded as income; in fact, they are the very opposite. In this case the petitioner has disbursed something more than $600,000 in cash dividends to policyholders who paid no premiums during the tax year. It can not be pretended that any part of these disbursements have been included in its gross income; and, as seen above, when its counsel comes to state accurately its case, he can not and does not claim that these disbursements have been so included. All that he can do is to assert a claim that there should be excluded from the actual gross income *a sum equal to the dividends paid in cash*. Obviously, this is not a claim that anything has been improperly included in gross income, but, on the contrary, it is a claim that from the gross income, properly ascertained, as it has been, a deduction should be allowed on account of these dividends. But, as we have seen, a dividend is the very thing for which the statute says no

deduction shall be made. The direction that a certain part of income actually received shall not be included or treated as income for a certain year is by no means equivalent to saying that there shall be excluded from the gross income an amount equal to payments which the company has made on any account. To say that these dividends have been included in gross income is a contradiction in terms. No statute was necessary to prevent their being so included, for, in the very nature of things, it would never occur to anyone to treat disbursements as income.

When a part of a premium due in 1913 has been paid by an overpayment in the premium paid in 1912, the statute only makes the return speak the truth when it says that that portion of the premium which was, in fact, received by the company in 1912 shall not be treated as a part of the income of 1913. Indeed, it would hardly seem necessary that the statute should contain any express provision to this effect. Probably the only reason for the provision in question was that, under the excise tax act of 1909 (36 Stat., c. 6, p. 112), it was contended that the full amount of premiums collected in a given year was to be treated as income for that year regardless of whether a part of them were paid by applying thereto excess payments made in previous years; in other words, such dividends as are involved in this case.

In the case of *Herold* v. *Mutual Benefit Life Insurance Company*, 201 Fed. 918, it had been decided by a district court and a circuit court of appeals that

this contention was not sound. At the time the act of 1913 was passed, however, that case was pending in the Supreme Court on an application for writ of certiorari. (231 U. S. 755.) It was, therefore, a disputed question, and the language used in the act of 1913 was manifestly intended to put that question at rest for the future. The result is that so much of any premium due in a particular year as is paid by a repayment or credit of a dividend due the policyholder is not to be treated as income for that year. But when the amount of the premium, thus reduced, has been included in gross income, the provision in question has been given its full effect.

III.

An examination of other provisions of the statute makes it clear that Congress intended the provision to have exactly the meaning which it has been given above.

Very illogically, it is apprehended, petitioner bases an argument upon the fact that in the case of mutual *marine* insurance companies the amounts repaid to policyholders, on account of premiums previously paid by them, are deducted from gross income. As an argument addressed to Congress, and intended to convince that body that a like deduction *ought to be made* in the case of mutual *life* insurance companies, this might have great weight. But for reasons satisfactory to itself, and doubtless arising out of the different character of business done by the several kinds

of insurance companies, Congress has seen fit to deal separately with three kinds of mutual insurance companies. If it had thought proper to treat all alike in this respect it would have been necessary only to frame one proviso and make it applicable to "mutual, fire, marine, and life insurance companies." Instead, it framed three provisos. So far from indicating a purpose to treat all these companies alike, it thus clearly indicated the view that there were reasons why they should be treated differently. In the case of mutual fire insurance companies it saw fit to require only so much of premium deposits as should not be returned to policyholders to be included. Here the statute deals with *premium deposits as a whole*, and the result is that the gross income from premiums is to be the difference between the total premium deposits received during a particular year and the total amount of premium deposits returned to policyholders during the same year. Mutual marine insurance companies, however, are to return the *gross amount of premiums collected;* and, instead of excluding any part of these premiums, it is provided that the company shall be entitled to a *deduction from gross income* to the extent of the amount repaid to policyholders on account of premiums previously paid by them.

Here again Congress dealt with *premiums as a whole*, and with the *gross amount repaid to policyholders as a whole*. It is clear that these companies, after including in their gross income the

full amount of premiums collected during the year, are then entitled to deduct the full amount of premiums which they have returned to all of their policyholders during the same year. But when Congress came to deal with mutual life insurance companies it pursued an entirely different policy. It provided for *no deduction* on account of repayment of premiums after the gross income should be once ascertained. It abandoned the plan of dealing with *either premiums or repayments as a whole*, and dealt with the *premium received from each individual policyholder and with repayments made to individual policyholders*. It did not provide that the gross income should be the difference between the amount of premiums collected and the amount repaid on account of previous collections. With these marked differences between the provisions made for each of the three kinds of insurance it is idle to say that the purpose was to put any two of them on the same basis. Congress has in each instance used the most explicit and the plainest language. Whether there were good reasons for the distinctions made can be determined only by an examination into the character of business done by each class of companies. This examination could be, and doubtless was, properly made by Congress to control it in a matter of policy. But the law-making power having adopted a policy and plainly declared it, it is unimportant what its reasons may have been.

When, in the case of mutual *marine* insurance companies, Congress thought that a deduction should be made equal to the amount of dividends paid to stockholders within a year, it said so in plain language. When it came to deal with mutual *life* insurance companies it did not see fit to allow such a deduction. It did not see fit, as in the case of mutual *fire* insurance companies, to exclude from income the full amount of premium deposits returned to policyholders. On the contrary, it simply provided that so much of the repayments to stockholders as were used to pay premiums in succeeding years should be treated as, to that extent, reducing the amount of income actually received during the later year. Repayments made to policyholders who paid no premiums in the year in which such repayments were made were simply left as disbursements or a distribution of profits, for which no deduction from gross income was provided. The very fact that such widely different language was used when dealing in the same section of the statute with different kinds of corporations is proof positive that the rule applied to one was not intended to be applied to the other.

The disbursement of funds by the payment of dividends is not income, was not included in the gross income upon which the taxes in this case were based, and constitutes no part of the premiums received by the company in the year for which the taxes in controversy were paid.

CONCLUSION.

It is respectfully submitted that the dividends in question can not be allowed as a deduction from gross income because expressly excluded by the statute from such deductions. Equally, they were not used to pay premiums which would otherwise have been included in the gross income for 1913, and hence the proviso with respect to mutual life insurance companies can have no application to them. The judgment of the Circuit Court of Appeals is right and should be affirmed.

WILLIAM L. FRIERSON,
Assistant Attorney General.

FEBRUARY, 1920.

PENN MUTUAL LIFE INSURANCE COMPANY *v.* LEDERER, COLLECTOR OF INTERNAL REVENUE.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

No. 499. Argued March 22, 23, 1920.—Decided April 19, 1920.

The Income Tax Law of October 3, 1913, c. 16, 38 Stat. 172, § II G. (b), provides that life insurance companies "shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year," and that "there be deducted from gross income . . . the sums other than dividends paid within the year on policy and annuity contracts." *Held*, that money derived by a mutual company from redundancy of premiums paid in previous years, and paid to policyholders during the tax year as dividends in cash, not applied in abatement or reduction of their current premiums, should not be deducted from premium receipts in computing gross income. P. 527.

No aid in construing an act of Congress can be derived from the legislative history of another passed six years later. P. 537.

258 Fed. Rep. 81, affirmed.

THE case is stated in the opinion.

Mr. George Wharton Pepper for petitioner.

Mr. Assistant Attorney General Frierson for respondent.

MR. JUSTICE BRANDEIS delivered the opinion of the court.

The Penn Mutual Life Insurance Company, a purely mutual legal reserve company which issues level-premium

insurance, brought this action in the District Court of the United States for the Eastern District of Pennsylvania to recover $6,865.03 which was assessed and collected as an income tax of one per cent. upon the sum of $686,503, alleged to have been wrongly included as a part of its gross income, and hence also of its net income, for the period from March 1, 1913, to December 31, 1913. The latter sum equals the aggregate of the amounts paid during that period by the company to its policyholders in cash dividends which were *not* used by them during that period in payment of premiums. The several amounts making up this aggregate represent mainly a part of the so-called redundancy in premiums paid by the respective policyholders in some previous year or years. They are, in a sense, a repayment of that part of the premium previously paid which experience has proved was in excess of the amount which had been assumed would be required to meet the policy obligations (ordinarily termed losses) or the legal reserve and the expense of conducting the business.[1] The District Court allowed recovery of the full amount with interest. (247 Fed. Rep. 559.) The Circuit Court of Appeals for the Third Circuit, holding that nothing was recoverable except a single small item, reversed the judgment and awarded a new trial. (258 Fed. Rep. 81.) A writ of certiorari from this court was then allowed. (250 U. S. 656.)

Whether the plaintiff is entitled to recover depends wholly upon the construction to be given certain provisions in § II G. (b) of the Revenue Act of October 3, 1913, c. 16, 38 Stat. 114, 172, 173. The act enumerates among

[1] The manner in which mutual level-premium life insurance companies conduct their business, and the nature and application of dividends are fully set forth in *Mutual Benefit Life Ins. Co.* v. *Herold*, 198 Fed. Rep. 199; *Connecticut General Life Ins. Co.* v. *Eaton*, 218 Fed. Rep. 188; *Connecticut Mutual Life Ins. Co.* v. *Eaton*, 218 Fed. Rep. 206.

the corporations upon which the income tax is imposed, "every insurance company" other than "fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system." It provides (C. (b) pp. 172–174) how the net income of insurance companies shall be ascertained for purposes of taxation, prescribing what shall be included to determine the gross income of any year, and also specifically what deductions from the ascertained gross income shall be made in order to determine the net income upon which the tax is assessed. Premium receipts are a part of the gross income to be accounted for.

In applying to insurance companies the system of income taxation in which the assessable net income is to be ascertained by making enumerated deductions from the gross income (including premium receipts) Congress naturally provided how, in making the computation,[1] repayment of the redundancy in the premium should be dealt with. In a mutual company, whatever the field of its operation, the premium exacted is necessarily greater than the expected cost of the insurance, as the redundancy in the premium furnishes the guaranty fund out of which extraordinary losses may be met, while in a stock company they may be met from the capital stock subscribed. It is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder. Some payment to the

[1] The percentage of the redundancy to the premium varies, from year to year, greatly, in the several fields of insurance, and likewise in the same year in the several companies in the same field. Where the margin between the probable losses and those reasonably possible is very large, the return premiums rise often to 90 per cent. or more of the premium paid. This is true of the manufacturers' mutual fire insurance companies of New England. See Report Massachusetts Insurance Commissioner (1913), vol. I, p. 16.

policyholder representing such excess is ordinarily made by every mutual company every year; but the so-called repayment or dividend is rarely made within the calendar year in which the premium (of which it is supposed to be the unused surplus) was paid. Congress treated the so-called repayments or dividends in this way (p. 173):

(a) Mutual fire companies "shall not return as income any portion of the premium deposits returned to their policyholders."

(b) Mutual marine companies "shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof."

(c) Life insurance companies (that is both stock and strictly mutual) "shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year."

(d) For all insurance companies, whatever their field of operation, and whether stock or mutual, the act provides that there be deducted from gross income "the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts."

The Government contends, in substance, for the rule that in figuring the gross income of life insurance companies, there shall be taken the aggregate of the year's net premium receipts made up separately for each policyholder.[1] The Penn Mutual Company contends for the

[1] A separate account is kept by the company with each policyholder. In that account there is entered each year the charges of the premiums payable and all credits either for cash payments or by way of credit of dividends, or by way of abatement of premium.

rule that in figuring the gross income there shall be taken the aggregate full premiums received by the company less the aggregate of all dividends paid by it to any policyholder by credit upon a premium or by abatement of a premium and also of all dividends whatsoever paid to any policyholder in cash whether applied in payment of a premium or not. The non-inclusion clause, (c) above, excludes from gross income those premium receipts which were actually or in effect paid by applying dividends. The company seeks to graft upon the clause so restricted a provision for what it calls non-including, but which in fact is deducting, all cash dividends not so applied. In support of this contention the company relies mainly, not upon the words of the statute, but upon arguments which it bases upon the nature of mutual insurance, upon the supposed analogy of the rules prescribed in the statute for mutual fire and marine companies and upon the alleged requirements of consistency.

First: The reason for the particular provision made by Congress seems to be clear: Dividends may be made, and by many of the companies have been made largely, by way of abating or reducing the amount of the renewal premium.[1] Where the dividend is so made the actual premium receipt of the year is obviously only the reduced amount. But, as a matter of bookkeeping, the premium is

[1] The dividend provision of the Mutual Benefit Life Insurance Company involved in the *Herold Case, supra*, 198 Fed. Rep. 199, 204, was, in part: "After this policy shall have been in force one year, each year's premium subsequently paid shall be subject to reduction by such dividend as may be apportioned by the directors." The dividend provision in some of the participating policies involved in the *Connecticut General Life Ins. Co. Case, supra*, 218 Fed. Rep. 188, 192, was: "Reduction of premiums as determined by the company will be made annually beginning at the second year, or the insured may pay the full premium and instruct the company to apply the amount of reduction apportioned to him in any one of the following plans:" (Then follow four plans.)

entered at the full rate and the abatement (that is, the amount by which it was reduced) is entered as a credit. The financial result both to the company and to the policyholders is, however, exactly the same whether the renewal premium is reduced by a dividend or whether the renewal premium remains unchanged but is paid in part either by a credit or by cash received as a dividend. And the entries in bookkeeping would be substantially the same. Because the several ways of paying a dividend are, as between the company and the policyholder, financial equivalents, Congress, doubtless, concluded to make the incidents the same, also, as respects income taxation. Where the dividend was used to abate or reduce the full or gross premium—the direction to eliminate from the apparent premium receipts is aptly expressed by the phrase "shall not include," used in clause (c) above. Where the premium was left unchanged, but was paid in part by a credit or cash derived from the dividend the instruction would be more properly expressed by a direction to deduct those credits. Congress doubtless used the words "shall not include" as applied also to these credits because it eliminated them from the aggregate of taxable premiums as being the equivalent of abatement of premiums.

That such was the intention of Congress is confirmed by the history of the non-inclusion clause, (c) above. The provision in the Revenue Act of 1913, for taxing the income of insurance companies is in large part identical with the provision for the special excise tax upon them imposed by the Act of August 5, 1909, c. 6, § 38, 36 Stat. 112. By the latter act the net income of insurance companies was, also, to be ascertained by deducting from gross income "sums other than dividends, paid within the year on policy and annuity contracts"; but there was in that act no non-inclusion clause whatsoever. The question arose whether the provision in the Act of 1909, identical with (c)

above, prevented using in the computation the reduced renewal premiums instead of the full premiums, where the reduction in the premium had been effected by means of dividends. In *Mutual Benefit Life Insurance Co.* v. *Herold*, 198 Fed. Rep. 199, decided July 29, 1912, it was held that the renewal premium as reduced by such dividends should be used in computing the gross premium; and it was said (p. 212) that dividends so applied in reduction of renewal premiums "should not be confused with dividends declared in the case of a full-paid participating policy, wherein the policyholder has no further premium payments to make. Such payments having been duly met, the policy has become at once a contract of insurance and of investment. The holder participates in the profits and income of the invested funds of the company." On writ of error sued out by the Government the judgment entered in the District Court was affirmed by the Circuit Court of Appeals on January 27, 1913, 201 Fed. Rep. 918; but that court stated that it refrained from expressing any opinion concerning dividends on full-paid policies, saying that it did so "not because we wish to suggest disapproval, but merely because no opinion about these matters is called for now, as they do not seem to be directly involved." The non-inclusion clause in the Revenue Act of 1913, (c) above, was doubtless framed to define what amounts involved in dividends should be "non-included," or deducted, and thus to prevent any controversy arising over the questions which had been raised under the Act of 1909.[1] The petition for writ of certiorari applied for by the Government was not denied by this court until December 15, 1913, (231 U. S. 755), that is, after the passage of the act.

[1] Substantially the same questions were involved, also, in *Connecticut General Life Ins. Co.* v. *Eaton*, 218 Fed. Rep. 188, and *Connecticut Mutual Life Ins. Co.* v. *Eaton*, 218 Fed. Rep. 206, in which decisions were not, however, reached until the following year.

Second: It is argued that the nature of life insurance dividends is the same, whatever the disposition made of them; and that Congress could not have intended to relieve the companies from taxation to the extent that dividends are applied in payment of premiums and to tax them to the extent that dividends are not so applied. If Congress is to be assumed to have intended, in obedience to the demands of consistency, that all dividends declared under life insurance policies should be treated alike in connection with income taxation regardless of their disposition, the rule of consistency would require deductions more far-reaching than those now claimed by the company. Why allow so-called non-inclusion of amounts equal to the dividends paid in cash but not applied in reduction of renewal premium and disallow so-called non-inclusion of amounts equal to the dividends paid by a credit representing amounts retained by the company for accumulation or to be otherwise used for the policyholders' benefit? The fact is, that Congress has acted with entire consistency in laying down the rule by which in computing gross earnings certain amounts only are excluded; but the company has failed to recognize what the principle is which Congress has consistently applied. The principle applied is that of basing the taxation on receipts of net premiums, instead of on gross premiums. The amount equal to the aggregate of certain dividends is excluded, although they are dividends, because by reason of their application the net premium receipts of the tax are to that extent less. There is a striking difference between an aggregate of individual premiums, each reduced by means of dividends, and an aggregate of full premiums, from which it is sought to deduct amounts paid out by the company which have no relation whatever to premiums received within the tax year but which relate to some other premiums which may have been received many years earlier. The difference between the two

cases is such as may well have seemed to Congress sufficient to justify the application of different rules of taxation.

There is also a further significant difference. All life insurance has in it the element of protection. That afforded by fraternal beneficiary societies, as originally devised, had in it only the element of protection. There the premiums paid by the member were supposed to be sufficient, and only sufficient, to pay the losses which will fall during the current year; just as premiums in fire, marine, or casualty insurance are supposed to cover only the losses of the year or other term for which the insurance is written. Fraternal life insurance has been exempted from all income taxation; Congress having differentiated these societies, in this respect as it had in others, from ordinary life insurance companies. Compare *Supreme Council of the Royal Arcanum* v. *Behrend*, 247 U. S. 394. But in level-premium life insurance, while the motive for taking it may be mainly protection, the business is largely that of savings investment. The premium is in the nature of a savings deposit. Except where there are stockholders, the savings bank pays back to the depositor his deposit with the interest earned less the necessary expense of management. The insurance company does the same, the difference being merely that the savings bank undertakes to repay to each individual depositor the whole of his deposit with interest; while the life insurance company undertakes to pay to each member of a class the average amount (regarding the chances of life and death); so that those who do not reach the average age get more than they have deposited, that is, paid in premiums (including interest) and those who exceed the average age less than they deposited (including interest). The dividend of a life insurance company may be regarded as paying back part of these deposits called premiums. The dividend is made possible because the amounts paid in as premium have earned

more than it was assumed they would when the policy contract was made, or because the expense of conducting the business was less than it was then assumed it would be or because the mortality, that is the deaths in the class to which the policyholder belongs, proved to be less than had then been assumed in fixing the premium rate. When for any or all of these reasons the net cost of the investment (that is, the right to receive at death or at the endowment date the agreed sum) has proved to be less than that for which provision was made, the difference may be regarded either as profit on the investment or as a saving in the expense of the protection. When the dividend is applied in reduction of the renewal premium, Congress might well regard the element of protection as predominant and treat the reduction of the premium paid by means of a dividend as merely a lessening of the expense of protection. But after the policy is paid up, the element of investment predominates and Congress might reasonably regard the dividend substantially as profit on the investment.

The dividends, aggregating $686,503, which the Penn Mutual Company insists should have been "non-included," or more properly deducted, from the gross income, were, in part, dividends on the ordinary limited payment life policies which had been paid-up. There are others which arose under policy contracts in which the investment feature is more striking; for instance, the Accelerative Endowment Policy or such special form of contract as the 25-year "6% Investment Bond" matured and paid March, 1913, on which the policyholder received besides dividends, interest and a "share of forfeitures." In the latter, as in "Deferred Dividend" and other semi-tontine policies, the dividend represents in part what clearly could not be regarded as a repayment of excess premium of the policyholder receiving the dividend. For the "share of the forfeiture" which he receives is the share of the redundancy in premium of other policyholders who

did not persist in premium payments to the end of the contract period.

Third: The non-inclusion clause here in question, (c) above, is found in § II G. (b) in juxtaposition to the provisions, concerning mutual fire and mutual marine companies, clauses (a) and (b) above. The fact that in three separate clauses three different rules are prescribed by Congress for the treatment of redundant premiums in the three classes of insurance, would seem to be conclusive evidence that Congress acted with deliberation and intended to differentiate between them in respect to income taxation. But the company, ignoring the differences in the provisions concerning fire and marine companies respectively, insists that mutual life insurance rests upon the same principles as mutual fire and marine and that as the clauses concerning fire and marine companies provide specifically for non-inclusion in or deduction from gross income of all portions of premiums returned, Congress must have intended to apply the same rule to all. Neither premise nor conclusion is sound.

Mutual fire, mutual marine and mutual life insurance companies are analogous in that each performs the service called insuring wholly for the benefit of their policyholders and not like stock insurance companies in part for the benefit of persons who as stockholders have provided working capital on which they expect to receive dividends representing profits from their investment. In other words, these mutual companies are alike in that they are coöperative enterprises. But in respect to the service performed fire and marine companies differ fundamentally, as above pointed out, from legal reserve life companies. The thing for which a fire or marine insurance premium is paid is protection, which ceases at the end of the term. If after the end of the term a part of the premium is returned to the policyholder, it is not returned as something purchased with the premium, but as a part of the premium

which was not required to pay for the protection; that is, the expense was less than estimated. On the other hand, the service performed in level-premium life insurance is both protection and investment. Premiums paid—not in the tax year, but perhaps a generation earlier—have earned so much for the coöperators, that the company is able to pay to each not only the agreed amount but also additional sums called dividends; and have earned these additional sums, in part at least, by transactions not among the members, but with others; as by lending the money of the coöperators to third persons who pay a larger rate of interest than it was assumed would be received on investments. The fact that the investment resulting in accumulation or dividend is made by a coöperative as distinguished from a capitalistic concern does not prevent the amount thereof being properly deemed a profit on the investment. Nor does the fact that the profit was earned by a coöperative concern afford basis for the argument that Congress did not intend to tax the profit. Congress exempted certain coöperative enterprises from all income taxation, among others, mutual savings banks; but, with the exception of fraternal beneficiary societies, it imposed in express terms such taxation upon "every insurance company." [1]

The purpose of Congress to differentiate between mutual fire and marine insurance companies on the one hand and life insurance companies on the other is further manifested by this: The provision concerning return premiums in computation of the gross income of fire and marine insurance companies is limited in terms to mutual companies, whereas the non-inclusion clause, (c) above, relating to life

[1] The alleged unwisdom and injustice of taxing mutual life insurance companies while mutual savings banks were exempted had been strongly pressed upon Congress. Briefs and statements filed with Senate Committee on Finance on H. R. 3321—Sixty-third Congress, first session, Vol. 3, pp. 1955–2094.

insurance companies, applies whether the company be a stock or a mutual one. There is good reason to believe that the failure to differentiate between stock and mutual life insurance companies was not inadvertent. For while there is a radical difference between stock fire and marine companies and mutual fire and marine companies, both in respect to the conduct of the business and in the results to policyholders, the participating policy commonly issued by the stock life insurance company is, both in rights conferred and in financial results, substantially the same as the policy issued by a purely mutual life insurance company. The real difference between the two classes of life companies as now conducted lies in the legal right of electing directors and officers. In the stock company stockholders have that right; in the mutual companies, the policyholders who are the members of the corporation.

The Penn Mutual Company, seeking to draw support for its argument from legislation subsequent to the Revenue Act of 1913, points also to the fact that by the Act of September 8, 1916, c. 463, 39 Stat. 756, 768, § 12, subsection second, subdivision c, the rule for computing gross income there provided for mutual fire insurance companies was made applicable to mutual employers' liability, mutual workmen's compensation and mutual casualty insurance companies. It asserts that thereby Congress has manifested a settled policy to treat the taxable income of mutual concerns as not including premium refunds; and that if mutual life insurance companies are not permitted to "exclude" them, these companies will be the only mutual concerns which are thus discriminated against. Casualty insurance, in its various forms, like fire and marine insurance, provides only protection, and the premium is wholly an expense. If such later legislation could be considered in construing the Act of 1913, the conclusion to be drawn from it would be clearly the opposite of that urged. The later act would tend to show that Congress

persists in its determination to differentiate between life and other forms of insurance.

Fourth: It is urged that in order to sustain the interpretation given to the *non-inclusion* clause by the Circuit Court of Appeals (which was, in effect, the interpretation set forth above) it is necessary to interpolate in the clause the words "within such year," as shown in italics in brackets, thus:

"And life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder [*within such year*] as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year."

What has been said above shows that no such interpolation is necessary to sustain the construction given by the Circuit Court of Appeals. That court did not hold that the permitted non-inclusion from the year's gross income is limited to that portion of the premium received within the year which, by reason of a dividend, is paid back within the same year. What the court held was that the non-inclusion is limited to that portion of the premium which, although entered on the books as received, was not actually received, within the year, because the full premium was, by means of the dividend, either reduced, or otherwise wiped out to that extent. Nor does the Government contend that any portion of a premium, not received within the tax year, shall be included in computing the year's gross income. On the other hand what the company is seeking is not to have "non-included" a part of the premiums which were actually received within the year, or which appear, as matter of bookkeeping to have been received but actually were not. It is seeking to have the aggregate of premiums actually received within the year *reduced* by an amount which the company paid out within

the year; and which it paid out mainly on account of premiums received long before the tax year. What it seeks is not a *non-inclusion* of amounts paid in—but a *deduction* of amounts paid out.

If the terms of the non-inclusion clause, (c) above, standing alone, permitted of a doubt as to its proper construction, the doubt would disappear when it is read in connection with the deduction clause, (d) above. The deduction there prescribed is of "the sums other than dividends paid within the year on policy and annuity contracts." This is tantamount to a direction that dividends shall not be deducted. It was argued that the dividends there referred to are "commercial" dividends like those upon capital stock; and that those here involved are dividends of a different character. But the dividends which the deduction clause says, in effect, shall not be deducted, are the very dividends here in question, that is dividends "on policy and annuity contracts." None such may be deducted by any insurance company except as expressly provided for in the act, in clauses quoted above, (a) (b) and (c). That is, clauses (a) (b) and (c) are, in effect, exceptions to the general exclusion of dividends from the permissible deductions as prescribed in clause (d) above.

In support of the company's contention that the interpolation of the words "within the year" is necessary in order to support the construction given to the act by the Circuit Court of Appeals we are asked to consider the legislative history of the Revenue Act of 1918 (enacted February 24, 1919, c. 18, 40 Stat. 1057); and specifically to the fact that in the bill as introduced in and passed by the House, the corresponding section (233 (a)) contained the words "within the taxable year" and that these words were stricken out by the Conference Committee (Report No. 1037, 65th Cong., 3d sess.) The legislative history of an act may, where the meaning of the words used is doubt-

ful, be resorted to as an aid to construction. *Caminetti* v. *United States*, 242 U. S. 470, 490. But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question. Further answer to the argument based on the legislative history of the later act would, therefore, be inappropriate.

We find no error in the judgment of the Circuit Court of Appeals. It is

Affirmed.